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THESIS TITLE

ARBITRAL DISCRETION AND THE ASSESSMENT OF COMPENSATION AND DAMAGES IN INVESTOR-STATE ARBITRATION

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THESIS ABSTRACT

The aim of this thesis is to examine the nature and scope of arbitral discretion and its role in the assessment of compensation and damages in investor-state arbitration. The function of arbitrators and their decision-making process has come under increasing scrutiny with the sharp rise in the number of investor-state disputes and the large sums of compensation that have been awarded therein. The use of discretion by arbitrators in deciding issues of quantum is of particular relevance due to the significant extent to which such discretion can affect the total amount of compensation or damages that is eventually awarded to claimants. However, there is lack of a systematic understanding within legal scholarship on the nature of the discretionary authority of arbitrators, how it applies during arbitral proceedings on quantum and the factors that limit and control the use of discretion. There is also limited knowledge presently regarding the interplay of considerations of equity, fairness and reasonableness in that animates the exercise of discretion by arbitral tribunals in making determinations. This thesis aims to fill this gap in legal literature by taking a doctrinal approach to examination of arbitral discretion and its varied application at the different stages of determinations regarding compensation and damages, Thus, the findings of this thesis contributes to the scholarship on arbitral decision-making in international arbitration as well as on issues of compensation and damages in international investment law.

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Chapter 1

Discretion and the investor-state arbitral process: An introduction

1. Background

The international arbitral process governing the settlement of foreign investment disputes is at a critical state of evolution. Now more than ever in the four decades of use of arbitration for settling the international legal rights of foreign investors, the mechanism of arbitration itself is considered to be undergoing a period of legitimacy crisis[1]. The symptoms of this crisis are visible in various shapes and forms: rising instances of challenges against the appointment of arbitrators, exit from treaties and conventions governing the administration of investor-state disputes, efforts at investment treaty reform that limits access to dispute settlement mechanisms, all of which have contributed towards increased global efforts at finding institutional alternatives to the predominantly arbitration-based system[2]. But what factors have precipitated this so-called crisis? Are the problems real or, as some argue, largely the product of misplaced perceptions among critics?[3] Although a satisfactory answer to the question is difficult to arrive at without engaging in polarising narratives, it is evident that states are actively considering alternatives to arbitration[4]. Perhaps the most widely discussed reform measures in this regard include the proposal for the establishment of a two-tier multilateral investment court (MIC) that purportedly addresses key procedural deficiencies in investor-state arbitration. These deficiencies or issues of concern are generally enumerated as: inconsistency and incoherence in the interpretation of investment treaty clauses, incorrect decisions, lack of independence and impartiality of arbitrators as adjudicators in disputes as well as excessive costs[5].

[1] Thomas Dietz, Marius Dotzauer & Edward S. Cohen, 'The Legitimacy Crisis of Investor-State Arbitration and the New EU Investment Court System' (2019) 26 Review of International Political Economy 4 749

[2] Sergio Puig and Gregory Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law' (2018) 112 American Journal of International Law 361

[3] Devashish Krishnan, 'Thinking About BITs and BIT Arbitration: The Legitimacy Crisis That Never Was' in Todd Weiler and Freya Baetens (eds.), New Directions in International Law (Brill Nijhoff 2011)

[4] Malcolm Langford, Michele Potestà, Gabrielle Kaufmann-Kohler and Daniel Behn, 'Special Issue: UNCITRAL and Investment Arbitration Reform: Matching Concerns and Solutions' (2020) 21 Journal of World Investment and Trade 2

[5] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session' (2018) UN Doc A/CN.9/935

For states as key stakeholders of the global network of over 3,000 international investment agreements, issues of compensation and damages have always been particularly important. The investor-state dispute settlement (ISDS) is structured towards providing remedies of restitution or monetary damages to qualified foreign investors affected by unlawful acts or omissions by host-states that breach investment treaties or contracts. Billions of dollars' worth of compensation and damages have consequently been awarded to foreign investors so far ever since the different mechanisms for ISDS have been incorporated, including institutional and ad hoc arbitrations besides prior bodies like the Iran-United States Claims Tribunal (IUSCT). Some of the largest sums of compensation and damages awarded by any international adjudicatory system can be attributed to arbitration-based ISDS, such as the infamous *Yukos* awards where the Russian state was found liable for over 50 billion USD in compensation[6]. Besides high-profile cases, surveys have shown that claim sizes in investor-state disputes have exceed 250 million USD on average[7]. Particular concerns have been drawn to the possible destabilising impact of high-value damages awards against poor and developing states that may lack the resources to effectively contest foreign investor claims in the first place[8]. But beyond primarily systemic concerns, scholarly criticism and commentary has been drawn to the interpretation of legal principles governing compensation and damages, the process and methods involved in their calculation, along with arbitral reasoning and decision-making that leads to the findings on issues of quantum[9].

Significant challenges are involved in the process of calculation of compensation and damages arising from unlawful host-state actions. The varying range of complexity of investment projects and the limited guidance on compensation and damages within the applicable law contribute to a high degree of uncertainty in determining the "correct" amount that must be awarded to the claimant. Challenges also arise in the measurement of the claimant's alleged losses on the basis of availability of evidence, the disputing parties' submissions, the quality of party-appointed and tribunal-appointed experts, along with the

[6] *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 227, Final Award, (July 18, 2014); *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 226, Final Award, (July 18, 2014); *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 228, Final Award (July 18, 2014)

[7] T.H. Hart and R. Vélez, 'Study of Damages Awards in Investor-State Cases' (2021) Transnational Dispute Management (advanced publication)

[8] Martins Paparinskis, 'A Case Against Crippling Compensation in International Law of State Responsibility' (2020) The Modern Law Review 1

[9] Thomas W. Wälde and Borzu Sabahi, 'Compensation, Damages, and Valuation' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008)

arbitral tribunal's own competence. These diverse factors can, to varying degrees, determine the final awards on quantum. Consequently, damages awards in investor-state exhibit inconsistencies in terms of the application of legal and financial principles by arbitral tribunals. To a certain degree, such inconsistencies are unavoidable given the distinct factual circumstances and the nature of investment involved in a particular case. However, divergences do arise on issues that may touch on legal and valuation principles, such as the threshold for selection of valuation standards, application of valuation criteria and methods, the determination of interest rates and the application of factors that lead to adjustments or reductions in the final value of compensation and damages. The process of decision-making by various arbitral tribunals takes centre-stage in any discussion involved in this context as it is the very arbitral awards and the de-facto system of arbitral jurisprudence created by these awards that shape and define the process of quantification[10]. While practitioners have written about some of the issues concerning the contrasting positions taken by tribunals for some time, arbitral scholarship on these issues has gained more prominence in recent years[11]. The rise in financial stakes and complexity involved in issues of quantum in investor-state disputes over time has led to growing interest in arbitral decision-making regarding quantification of damages as much as it has on issues of interpretation of the international legal standards of investment protection.

A common thread that connects contemporary critique of ISDS, whether on issues of interpretation of treaty standards or determination of damages is that of arbitral reasoning or decision-making. As noted earlier, the often-repeated issues of inconsistency, incoherence and incorrectness arise from the manner in which arbitral tribunals interpret and apply investment treaty standards. The fragmented nature of international investment law and arbitral practice can partly be ascribed to the ad hoc nature of investor-state arbitral proceedings, with no centralised corrective mechanism like an appellate body[12]. Moreover, arbitral tribunals themselves are not bound by a condition or compulsion to follow prior awards, though it is quite common in practice for tribunals to refer to and follow the reasoning applied in such awards. More than at any other stage, the tendency of arbitral

[10] Silke Noa Elrifai, 'Equity-Based Discretion and the Anatomy of Damages Assessment in Investment Treaty Law' (2017) 34 Journal of International Arbitration 5

[11] Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (BIICL 2008); Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (Wolters Kluwer 2008) Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (Oxford University Press 2017)

[12] Jürgen Kurtz, *The WTO and International Investment Law: Converging Systems* (Cambridge University Press 2016)

tribunals of resorting to a de-facto precedent rule is quite common at the stage of quantum. In fact, several aspects of quantum assessments are driven by arbitral practice rather than an applicable treaty provision or a procedural rule of arbitration. This aspect of decision-making is referred as the exercise of arbitral discretion, considering that it is derived principally from the discretionary authority of arbitral tribunals. Rooted firmly in the disputing parties' mutual consent to arbitrate, the discretionary authority of arbitral tribunals enables arbitrators to make decisions on a wide range of procedural and substantive issues that may not be clearly defined within the applicable law in investor-state disputes. A classic example of the use of this discretion is the process of determination of interest that would be applicable to an award on quantum. While certain treaties require that an 'appropriate' rate of interest be awarded to the party eligible to receive compensation, it is left to the tribunal to identify a rate that it considers to be appropriate[13]. Consequently, the arbitral tribunal considers the submissions of the parties to evaluate against its own set of preferences in determining the rate of interest. The exercise of arbitral discretion is at its core the application of the tribunal's preferences regarding a given issue for determination.

The nature of the discretionary authority of arbitrators and the scope of use of arbitral discretion is a subject that has remained marginal within broader discourses on arbitral decision-making[14]. While the general discretionary authority of arbitrators to regulate arbitral proceedings is implicitly recognised under most procedural laws of arbitration, limited efforts have been made within legal scholarship towards defining arbitral discretion as a legal concept[15]. Beyond a general consensus regarding discretion as constituting the exercise of some form of choice or preference, discretion is understood and conceived in a variety of contexts. The idea of judicial discretion also exerts significant influence in terms of lending its conceptual underpinnings to the arbitral context. The classical positivist conception of judicial discretion, as explained by H.L.A. Hart as the resort to discretion by judges in the absence of an applicable legal rules or due to vagueness in rules, seems to be reflected also in the manner in which arbitral discretion is applied and understood in arbitration[16]. However, arbitration scholarship does not have much to say regarding this connection between arbitral discretion and the judicial context. A substantive theoretical treatment of arbitral discretion is

[13] See Chapter 3 for a discussion on the application of interest rates to awards on quantum.
[14] Mary Mitsi, *The Decision-Making Process of Investor-State Arbitral Tribunals* (Wolters Kluwer 2019)
[15] Sophie Nappert, 'International Arbitration as a Tool of Global Governance: The Use (and Abuse) of Discretion' in Eric Brousseau, Jean-Michel Glachant, and Jérôme Sgard (eds.), *The Oxford Handbook of Institutions of International Economic Governance and Market Regulation* (Oxford University Press 2019)
[16] H.L.A. Hart, *The Concept of Law* (Oxford: Clarendon Press, 1994)

missing within the broader discourse on international arbitration. In practice, discretion has never been considered to be free-flowing but bound by considerations of fairness and reasonableness. Beyond these general assumptions, there have been limited attempts at grappling with the "slippery eel" of discretionary authority and its implications for the arbitral process[17]. The idea of discretion as the application of arbitrator preferences based on 'equitable' considerations seems to be the presumption among several scholars writing about discretion in the context of investor-state arbitration[18]. Therefore, discretion in investor-state arbitration has so far remained as a concept vaguely formed and only partly realised. While reference to arbitral discretion has been made on numerous occasions by arbitral tribunals in the decision-making process, there have been few attempts at understanding the scope of discretion, how it is involved in various stages of the arbitral process and the means by which control can be exercised against excessive or unreasonable discretion.

The use of arbitral discretion by tribunals in the assessment of compensation and damages in investor-state disputes is a fairly common practice. Invoking their discretionary authority in varied terms, including "wide discretion", "margin of discretion" or "margin of estimation", arbitral tribunals make decisions that substantively affect the amount of compensation or damages that are eventually awarded. This discretionary authority pervades almost every aspect of the assessment process, starting with the various tools for measurement of losses until the final adjustments to value are applied to the total amount of compensation or damages calculated. Moreover, this exercise of discretion may be motivated by considerations of equity, reasonableness and fair treatment of the disputing parties that may not always be evident on the face of the award.

The principal issue of concern with the exercise of discretion has to do with the outcome that it entails. No two tribunals may apply their discretionary authority in exactly the same manner, given the natural differences among arbitrators as individuals in terms of their specific range of preferences and choices. Consequently, greater reliance on discretion may lead to widely different appreciation of factual-legal questions, particularly when there are limited principles guiding arbitrators in their assessment process. This is precisely the case

[17] Gabriel N. Alexander, 'Discretion in Arbitration' (1971) Proceedings of the National Academy of Arbitrators <http://naarb.org//proceedings/pdfs/1971-84.pdf>

[18] Elrifai (n 10). See also, Meriam N. Alrashid, 'The Arbitral Tribunal's Discretion in Quantifying Damages' as well as JF Merizalde Urdaneta, 'Proportionality, Contributory Negligence and Other Equity Considerations in Investment Arbitration', in Ian A. Laird et al. (eds.), *Investment Treaty Arbitration and International Law* (JurisNet 2015)

with quantum issues in investor-state arbitration, where the fact-based nature of determinations combine with the limited reach of legal principles governing quantification of compensation and damages. This leads to the so-called 'wide margin' of discretion that is referred to by arbitral tribunals while making determinations affecting quantum. Critics argue that is the different ways in which arbitral discretion is exercised by arbitral tribunals that leads to inconsistent decisions regarding crucial questions such as the appropriate method of valuation and the basis for its determination[19].

Resorting to discretion also leaves the door open for equitable considerations to enter the decision-making process. A tribunal that is positively disposed towards making decisions on the basis of equitable considerations may do so by invoking its discretion, even though an award based on equity may not have been the intention of the disputing parties[20]. Equity in itself is a fairly flexible concept providing arbitrators with a wide range of outcomes to choose from, where none of the outcomes could be considered to be incorrect. In situations where tribunals find it difficult to choose between one outcome over the other, resorting to discretion allows the tribunal to choose an outcome without having to enter into a detailed explanation on why one choice must necessarily prevail over the other. In other words, discretion enables tribunals to make decisions concerning compensation and damages under conditions of uncertainty, where multiple outcomes are possible. For example, arbitral discretion is frequently invoked when arbitral tribunals need to reduce the overall amount of compensation due to the claimant's own actions contributing to the quantum of losses sustained. Tribunals usually do this by apportioning losses between the parties on a percentage basis, where the percentage value reflects the degree of the claimant's contributory fault. Therefore, a 50 percent apportionment of losses would imply that a tribunal has decided that the claimant must bear half of the total value of calculated losses that it incurred due to its contributory fault[21]. It becomes evident here that tribunals can opt for any basis of apportionment that they find appropriate, although considerations of fairness and reasonability may limit the options that can be chosen when exercising discretion. The subjective nature of discretion, the margin of estimation that it grants tribunals combined with equitable considerations leads to divergence in arbitral practice, contributing to uncertainty

[19] Joshua B. Simmons, 'Valuation in Investor-State Arbitration: Toward a More Exact Science' in John N. Moore, *International Arbitration: Contemporary Issues and Innovations* (Brill Nijhoff 2013)
[20] Urdaneta (n 18)
[21] See for instance, *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment (21 March 2007)

and unpredictability of arbitral decision-making, all of which ultimately threaten the legitimacy of the arbitral system[22].

An additional aspect that must also be considered is the lack of clear reasons or explanations accompanying decisions that involve the use of arbitral discretion. The requirement to state reasons for a decision is present in all major procedural rules of arbitration as well as in a significant number of investment treaties. The statement of reasons is also expressly recognised as a requirement in adjudicatory processes by international courts and tribunals like the International Court of Justice (ICJ)[23]. However, awards on quantum issued in investor-state arbitral proceedings have been critiqued for the failure of tribunals to provide clear explanations for the calculations used or the reasoning applied therein[24]. In certain cases, damages awards have been annulled for failure to state reasons under proceedings of the International Centre for Settlement of Investment Disputes (ICSID). Decisions involving exercise of discretion are particularly vulnerable, given that discretionary authority may be used to justify decisions that are particularly difficult to explain or reason. The tendency of tribunals to make decisions that they deem appropriate based on their discretion may effectively act as a way of bypassing reasoning requirements or to get away with inadequate reasoning[25]. The consequence of the use of discretion in such a manner lies in the indeterminacy of quantum awards in terms of ascertaining how the tribunal decided on a particular outcome. The resulting lack of transparency and clarity of awards further adds to the legitimacy issues with the arbitral process.

2. Aim of the Thesis

Given the varied issues and understandings regarding the exercise of discretion, the aim of this thesis is to reach a comprehensive understanding regarding the nature and scope of the arbitral tribunal's discretionary authority in the specific context of investor-state arbitration. This thesis proposes that arbitral discretion pervades every aspect of the decision-making process involving the calculation of compensation and damages, but this pervasiveness is not

[22] See Chapter 5 for a discussion on inconsistency and incoherence problems in arbitral decision-making that contributes to the legitimacy crisis.
[23] Christoph H. Schreuer et al., *The ICSID Convention: A Commentary* (Cambridge University Press 2nd ed. 2013)
[24] Sean Stephenson, 'Quantum and Reasons in Investment Treaty Arbitration: The Next Reasoning Frontier?' (2021) ICSID Review (advanced publication)
[25] Federico Ortino, 'Legal Reasoning of International Investment Tribunals: A Typology of Egregious Failures' (2012) 3 Journal of International Dispute Settlement 1

uniform at each stage of the overall chain of determinations involved. While certain aspects of the determination process are governed by legal and financial principles that allow for limited discretion, there is also an opposite side of the scale where the tribunal's discretionary authority is extensive and wide-ranging. The tribunal's discretion therefore extends and shrinks in a flexible, accordion-like manner during different stages of the determination process. By examining the varied discourses regarding the use of discretion that can be inferred from international treaty texts, legal principles and rules, arbitral awards and legal scholarship, the thesis seeks to construct a composite image of arbitral discretion in its application to issues of quantum. The choice made in this thesis to focus solely on quantum-related issues arises from the often-repeated observation that arbitral tribunals have the broadest discretion at stage of proceedings concerned with the calculation of compensation and damages[26]. This allows for a far more extensive examination of the varied ways in which the tribunal's discretionary authority is exercised in the process of decision-making than it would be possible if issues of legal liability or costs were considered. Moreover, the determination of quantum issues is an essential part of the investor-state arbitral process that carries the highest importance for the disputing parties: the claimant-investor as well as the respondent-state. However, this area of legal research is relatively unexplored, with limited treatment given to arbitral discretion as a factor in the decision-making process of tribunals. Therefore, the focus on the assessment of compensation and damages allows for a substantive treatment of the subject and a clearer understanding of discretion in action.

It is also important to state here the limitations of the present thesis work. This thesis does not intend to evaluate the preferences of arbitrators or how they are implemented in the exercise of discretionary authority. Any research work for this purpose would require an understanding of the mind of the arbitrator and the specific causal factors in each individual case. It would also require an assessment that goes beyond legal analysis into economic, sociological and psychological perspectives in understanding the policy goals of arbitrators as a specific class of actors in international arbitration[27]. Literature on the process of arbitral decision-making in international arbitration is an emerging area of interdisciplinary research work, whose insights have greatly benefited this thesis work. Thus, while the thesis draws

[26] Alrashid (n 18)

[27] Susan D. Franck, Anne van Aaken, James Freda, Chris Guthrie, and Jeffrey J. Rachlinski, 'Inside the Arbitrator's Mind' (2017) 66 Emory Law Journal 1115. See also, Tony Cole, Pietro Ortolani and Sean Wright, 'Arbitration in its Psychological Context: A Contextual Behavioural Account of Arbitral Decision-Making', in Thomas Schultz and Federico Ortino (eds.), *Oxford Handbook of International Arbitration* (Oxford University Press 2020). Tony Cole, *The Roles of Psychology in International Arbitration* (Wolters Kluwer 2017)

from such insights, it does not seek to make a contribution centred on the process of decision-making. Rather, it seeks to develop a distinctive legal conception of arbitral discretion in the context of quantum issues in investor-state arbitration. Rather than seeking to comprehend the mind of the arbitral tribunal, the thesis seeks to provide fresh insight into the manner of exercise of discretion in the making of awards on compensation and damages. The primary intended audience of this thesis comprises of the various stakeholders involved in the international investment law regime and in the ISDS process, including legal counsel and arbitrators, foreign investors, state representatives, various ISDS reform advocates as well as the general public.

It is also important to state that this thesis does not seek to take a reform-oriented approach to arbitral discretion. In order to consider the scope and desirability of reform, it is necessary to first identify the problems or issues involved in the exercise of discretion and the limitations of current mechanisms to deal defective reasoning or excessive reliance on discretion. However, there is presently an incomplete understanding of the latter aspect, requiring an inquiry to first focus on the mechanisms of the exercise of discretion and existing tools for addressing problems in discretion. Consequently, the scope of this thesis work is limited to this process of identification and evaluation of arbitral discretion in the particular context of quantum.

3. Methodology

With the specific aim of understanding the nature, scope and application of arbitral discretion in the assessment of compensation and damages as delineated above, this thesis work adopts the method of doctrinal legal research for its purpose. The doctrinal approach at its fundamental level seeks to understand 'what is the law' is in a given context, that is derived from an examination of relevant legal sources and materials[28]. The identification of distinct legal concepts, their scope and application in a given situation are generally identified using doctrinal approaches. The choice of adopting such a doctrinal approach in this thesis is motivated by the fact that there has been limited exploration and systemic understanding of arbitral discretion so far within the legal scholarship on international arbitration. It is difficult to evaluate arbitral discretion in context to legal processes without developing a clear

[28] Ian Dobinson & Francis Johns, 'Qualitative Legal Research' in Michael McConville & Wing Hong Chui (eds.), *Research Methods of Law* (Edinburgh University Press 2007)

conception of what is entailed by a reference by the tribunal to its discretionary authority. There is presently a lack of an understanding on arbitral discretion that is distinct from its various contexts. While this thesis does contextualise arbitral discretion within the decision-making process on quantum issues in investor-state arbitration, it does so only after developing a conceptual understanding of arbitral discretion in Chapter 2 of this thesis. The doctrinal method allows for an approach that seeks to evaluate the distinctive legal conception of discretion and its use in the decision-making process on quantum investor-state arbitration. The concept of arbitral discretion exists in a fragmented manner in within different sources of law, including international treaty texts, rules of arbitration and arbitral awards, requiring legal interpretation as well as qualitative analysis of these legal materials in order to accurately describe the meaning of arbitral discretion. For instance, the nature of discretionary authority of arbitral tribunals is identified from the limited powers given to the tribunals by the agreement to arbitrate. A qualitative analysis of the legal instruments that, either directly or indirectly, define the scope of powers of the tribunal provides the most accurate understanding of such discretionary authority that may exist. In seeking to identify arbitral discretion as a concept, this thesis identifies the doctrinal approach as most appropriate for its limited purpose.

The principal objects or sources for analysis in this thesis are the numerous arbitral awards and ICSID annulment committee decisions that have been issued over the past several decades. The arbitral awards, specifically awards on quantum, constitute the principal sources which have recorded the findings and observations of arbitral tribunals regarding the exercise of discretion. The degree to which arbitral tribunals or ICSID annulment committees dwell on the notion of arbitral discretion varies greatly. While some tribunals specifically invoke their discretionary authority while proceeding to make a decision or justify a decision already made, others do so indirectly by describing their decision on a particular issue in question. The fragmented nature of investor-state arbitration means that one would have to contend with often diverging or opposing views of tribunals in the process of evaluating arbitral understandings of the scope of discretion. The decisions of annulment committees within ICSID arbitration help in terms of gaining clarity of the underlying arbitral award to some degree, as annulment committees may provide some additional context to the arbitral award.

Beyond arbitral awards, investment treaty texts, customary international law and procedural rules of arbitration are the legal instruments that define and limit the scope of arbitral powers in general. However, these instruments do not specifically address the scope of arbitral

discretion and it must be derived by means of legal interpretation and analysis of specific rules. The investment treaty texts surveyed in this thesis work comprise of various bilateral investment treaties (BITs) and other international investment agreements that contain provisions governing compensation, monetary damages and specific requirements regarding the content of arbitral awards. Certain treaties also contain limitation provisions concerning the award of damages. Beyond treaties, the principle sources of international law that is relevant for the present work are the Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA) which were adopted by the International Law Commission in 2001 as a part of its efforts towards codifying customary international law principles governing state responsibility. Various articles of the ARSIWA that are relevant to the present thesis have been examined against the commentaries that have explained the customary principles contained in the draft articles. Finally, the procedural rules of arbitration that are selected by the parties to apply to the arbitral proceedings and constitute an important source for identifying the general procedural powers of the arbitral tribunal, including the procedural aspect of the tribunals discretionary authority.

In addition to legal texts and materials, the present thesis work has drawn significantly from leading works of arbitral scholarship, including books, journal articles, research reports and other commentaries. The scholarship on investor-state arbitration is a vast system of knowledge that draws not only from legal analysis but also from other fields of social science that have contributed to the current state of understanding on the arbitral process as well as alternative forms of dispute settlement. The various insights from academic research work have been quoted and cited throughout this thesis.

4. Structure of the Thesis

Having discussed the background to the research problem, the aims of the thesis and methods used, it is necessary to proceed with the substantive research work organised in four chapters. This structure of the thesis is as follows:

In Chapter 2, the fundamental concepts of arbitration law giving rise to and define the nature and scope of arbitral discretion are examined. This is done by exploring the foundational element of arbitral powers - arbitral authority and the legal sources of authority. The chapter

discusses the three principal sources: the arbitral agreement, procedural rules of arbitration law and *lex arbitri*.

In Chapter 3, the concept of arbitral discretion and the tribunal's discretionary authority is examined in the context of the standards of international law governing the award of compensation and damages, along with the legal/financial principles governing the valuation of investments for the purpose of ascertaining the losses suffered by the injured party. The chapter describes the various ways in which discretionary decision-making finds its way into the assessment of compensation and damages, and some of the necessities compelling tribunals to resort to discretion as well as some of the consequences of extensive reliance on discretion.

In Chapter 4, the thesis turns to assessment of process by which arbitral tribunals limit or reduce the calculated sum of compensation and damages that was determined by the application of legal and financial principles governing valuation. Considering the fact that the claimant investors in certain cases are also responsible in varying degrees for the losses sustained out of unlawful state actions, the chapter examined the role of discretion in quantifying the injured party's own responsibility for losses. In particular, the chapter examines the role of causation, contributory fault and the mitigation of damages as the subjects for exercise of discretionary authority.

In Chapter 5, having developed a broad-based understanding of arbitral discretion and its varying roles in the entirety of the process governing assessment of quantum, the thesis turns to the question of systemic problems arising out of the use of arbitral discretion. Taking the particular issue of lack of consistency and coherence as a consequence of the defective use of discretion, the chapter provides as assessment of the principal manner in which decision-making involving discretion is subject to control at the post-award stage. The analysis here is limited to the process of annulment that is available under the ICSID Convention as the principal means by which some degree of control that can be exerted on discretionary decision-making.

In Chapter 6, a general conclusion on the subject that is based on the key findings of the thesis has been presented.

Chapter 2

Exploring the Contours: Authority, Power, and the Foundations of Arbitral Discretion

1. Introduction

Investor-state arbitration is a complex, hybrid dispute settlement mechanism that incorporates elements from extensive sources of law. The decision-making process of international arbitrators involves questions of private and public rights that are executed via an arbitral framework. This arbitration-based dispute settlement system is facing a distinct set of challenges to its legitimacy. With growing research in the field, many facets of the arbitration-based system, including decision-making process of arbitrators has come under scrutiny in recent years. Scholarly criticism has focused on issues of inconsistency, incorrectness and opacity in the making of arbitral awards. One such aspect of decision-making that has received limited interest in research is that of the extensive discretionary powers of international arbitrators. In order to achieve a better understanding of the nature of discretionary powers and their impact on fact finding and decision-making processes, it is essential to understand the sources of discretionary authority within international investment law and the law of arbitration.

The purpose of this chapter is to examine the fundamental concepts of arbitration law that give effect to arbitral discretion. For this purpose, a bottom-up approach is taken in evaluating the foundational element of arbitral powers - arbitral authority and its sources. After locating arbitral authority within the larger scheme of consent of parties, the sources of arbitral powers in investor-State arbitration based on three primary sources – the arbitration agreement, procedural rules of arbitration and law of the seat of arbitration, or *lex arbitri*. This chapter is organised as follows – Section 2 begins with a brief introduction to arbitral discretion and its role in arbitral process. The sources of arbitral discretion are discussed in Section 3, divided into two parts: 3.1 examines arbitral authority, while 3.2 looks into arbitral powers. Each of these parts are further sub-divided in terms of their constitutive elements. Section 4 examines the scope of discretionary powers in the arbitral process, with its distinct procedural and substantive functions. Section 5 provides the conclusion to the findings of the chapter.

2. Discretion in the Arbitral Process

The need for discretion in any adjudicative process arises primarily out of uncertainty. In courts and tribunals around the world, it often becomes necessary for adjudicators to grapple with uncertainties in the facts or in the law regarding procedure or in the determination of the rights of parties. After all, adjudication is not merely about the mechanical application of law over the circumstances of a case. It requires adjudicators to make choices and decisions towards an outcome that is congruent with the applicable principles of law and justice. As the law cannot span the gamut of human interactions, it delegates the authority to judges to make choices and bridge gaps within legal systems. The exercise of discretion is, therefore, an essential function of judges in the course of their duties. The causes of uncertainty are often varied and require adjudicators to make a choice or determination out of a set of possibilities or actions. This free exercise of decision-making authority by judges and arbitrators in deciding an outcome broadly defines discretion within the adjudicative function.

Any discussion on adjudicative discretion is invariably tied to the question of extent and limits within which judges and arbitrators can make decisions on the basis of their sensibility and good judgement. The demand for rigour in the understanding of discretion is drawn from the need to maintain clear distinctions between free, unencumbered decision-making and arbitrariness. The amorphous meaning of 'discretion' and its varied connotations with individual choice, free decision-making, discernment, and responsibility adds further to uncertainty about its meaning. Black's Law Dictionary defines discretion in terms of its meaning as well as in its judicial context. It is defined in general defined as 'wise conduct and management; cautious discernment; prudence' and 'the power of free decision-making'[1]. On the other hand, judicial discretion is more specifically defined as:

> The exercise of judgment by a judge or court based on what is fair under the circumstances and guided by the rules and principles of law; a court's power to act or not act when a litigant is not entitled to demand the act as a matter of right.[2]

While the first part of the definition constitutes the exercise of judgment in terms of fairness and the boundaries of the law, the second part places an emphasis on the judge court's choice to act. It has also been suggested that judicial discretion is not about the exercise of the judge's will, but in the identification of the will of the law. Chief Justice John Marshall of the US

[1] Bryan A. Garner, *Black's Law Dictionary* (West 9th ed. 2009)
[2] Ibid 'Judicial Discretion'

Supreme Court viewed discretion as legal discretion that is exercised in discerning the course prescribed by law. After discerning the right course, it is the duty of the court to follow it. Further, discretion is never exercised for the purpose of giving effect to the will of the judge but always for giving effect to the "will of the law"[3].

A similar position is also found in the legal maxim *discretio est scire per legem quid sit justum*, meaning that discretion is the 'knowledge of that which is just by law'. This position reflects the idea that discretion cannot be exercised outside of the law but must be developed within it. The judge's discretion arises not out their personal opinion or convictions as to what is right, but in identifying the correct path prescribed by the law. But what if there are no legal signposts for the judge to follow? What if there is no established position of the law and the judge is faced with competing considerations? Would a judge be exceeding his/her powers by going where the law does not? Would such a decision be subject to review?

These questions are important in the context of this research project as they are key to understanding the function of discretion in the decision-making process of arbitrators. Like judges, arbitrators perform an adjudicative function in making determinations on the rights and liabilities of disputing parties. In investor-state arbitration, it is argued that the exercise of discretion is more relevant and apparent given the limited guidance provided by treaty-based sources of law, or by the governing rules of arbitration. Despite recent developments in treaty reform, most investment disputes involve adjudication over briefly worded and vague standards of investment protection that require extensive interpretation by arbitral tribunals to identify their scope and meaning. Even though there is no formalised rule of precedent in investor-state arbitration, the growing number of arbitral awards embody a distinct source of law that is continuously referred to and expanded by arbitral tribunals. But discretion is not limited to answering questions of treaty interpretation alone[4]. Arbitrators frequently exercise discretion over procedural and evidential issues, such as in the recording of evidence, witness examination, determination of the applicable standard of proof etc.[5]. In many ways, these procedural powers are broader than those afforded to judges in civil proceedings, where extensive procedural laws act as a constraint to the judge's discretion.

[3] *Osborn v. Bank of the United States*, 22 U. S. 738 (1824)
[4] Andrés Rigo Sureda, *Investment Treaty Arbitration: Judging Under Uncertainty* (Cambridge University Press 2012)
[5] Frederic G Sourgens, Kabir A.N. Duggal and Ian A Laird, *Evidence in International Investment Arbitration* (Oxford University Press 2018) 71-74

With regard to the taking of evidence in arbitration, Gary Born explains that most institutional rules of arbitration grant a 'broad discretion' to arbitral tribunals over taking of evidence. Further, it has also been held universally that these powers exist regardless of whether they are expressly authorized by the disputing parties[6].

The delegation of procedural powers to arbitral tribunals can also be gauged from model laws on arbitration, such as the UNCITRAL Model Law on International Commercial Arbitration (1985). Article 19(2) of the Model Law provides that where disputing parties have not agreed on the procedure to be followed by the arbitral tribunal:

> …the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

Further, the two most commonly applied arbitration rules in investor-state arbitrations, the ICSID Arbitration Rules (1968) and the UNCITRAL Arbitration Rules (1976), contain provisions empowering arbitral tribunals with discretion to organise and conduct arbitral proceedings. Rule 19 of the ICSID Arbitration Rules states that the Tribunal shall make the orders required for the conduct of the proceeding. Similarly, Article 15(1) of the UNCITRAL Arbitration Rules (1976) provides that the tribunal may conduct the arbitral process in such manner as it considers appropriate, provided that (1) the parties are treated with equality and (2) that each party is given a full opportunity of presenting his case. In the revised UNCITRAL Arbitration Rules of 2010, the same provision has been expanded under Article 17(1) to include the requirement that the tribunal shall conduct the proceedings in order to avoid "unnecessary delay and expense" and to provide a fair and efficient process for resolving the parties' dispute.

Major international institutions administering arbitrations similarly recognise this principle of allowing arbitral tribunals to determine procedure, subject to certain conditions. The procedural rules of the most prominent institutions contain similar provisions empowering arbitrators, such as under the International Chamber of Commerce (ICC) Rules of Arbitration 2017[7], the London Court of International Arbitration (LCIA) Arbitration Rules 2014[8], the Singapore

[6] Gary Born, *International Commercial Arbitration* (Kluwer Law International 2nd ed. 2009) 1890
[7] Article 22, ICC Rules of Arbitration 2017
[8] Article 14, LCIA Arbitration Rules 2014

International Arbitration Centre (SIAC) Rules 2016[9], the International Centre for Dispute Resolution (ICDR) Procedures 2014[10], among others.

From a plain reading of these various rules/articles governing conduct of proceedings, two important aspects related to arbitrator's procedural discretion become quite clear: (1) the discretion to conduct proceedings is not absolute, but subject to fairness and impartiality to the disputing parties (2) the discretion must be exercised with the aim of achieving an expedited dispute resolution process that is time and cost-efficient. Going further, these conditions can be conceived as constraints to arbitral discretion that also reveal the policy goals underlying the conferral of such powers to tribunals. The requirement of procedural fairness and equal treatment of parties ensures that arbitral tribunals do not resort to arbitrariness in the name of discretion. For example, Article 14.4 of the LCIA Arbitration Rules 2014 specifies two duties of the tribunal in conducting arbitral proceedings: (1) to act fairly and impartially between all parties and giving each a reasonable opportunity of putting its case and dealing with that of its opponents and (2) a duty to adopt procedures suitable to the circumstances of the arbitration, thereby avoiding unnecessary delay and expense. While the LCIA Arbitration Rules confer wide discretion to arbitral tribunals in discharging these duties, Article 14.4 provides a binding framework that constrains the exercise of such discretion. At the same time, it specifies the goal of a 'fair, efficient and expeditious' dispute resolution process towards which proceedings must be shaped by the arbitral tribunal.

The need for a balance between flexibility and procedural fairness in the conducting arbitral proceedings was expounded by Caron and Caplan in their influential commentary on the UNCITRAL Arbitration Rules 2010[11]. In their commentary to Article 17(1) the authors note that the article lies at the very heart of the UNCITRAL Arbitration process, laying down the principal foundation of party autonomy that distinguishes the arbitral process. They observe that the provision reflects the procedural flexibility which is generally regarded as one of the main advantages of arbitration. This procedural flexibility, however, must be balanced against the need for some ultimate control of procedural fairness and legal certainty concerning the international acceptance of the award. Thus, Caron and Caplan conclude that the ostensibly

[9] Rule 19, SIAC Rules 2016
[10] Article 20, ICDR International Dispute Resolution Procedures (Including Mediation and Arbitration Rules) 2014
[11] David D. Caron and Lee M. Caplan, *The UNCITRAL Arbitration Rules: A Commentary* (Oxford University Press 2nd ed. 2013)

wide discretion of the arbitrators is subject to certain limitations which follow directly from Article 17(1) as well as other provisions in the Rules[12].

In considering the limitations to the procedural discretion of arbitrators under the UNCITRAL Arbitration Rules, Cohen and Caplan identify five such limiting factors that are apparent from the Rules:

1. Limitations applicable under other specific rules that are applicable to the conduct of proceedings.
2. Equal treatment of the parties, including the provision of a reasonable opportunity to each party to present their case.
3. Avoiding unnecessary delay and expense and to provide a fair and efficient process for resolving the parties' dispute.
4. Any limitations imposed by modification of the UNCITRAL Arbitration Rules as agreed to by the parties.
5. Limitations imposed by the mandatory provisions of the applicable law of arbitration, from which the parties cannot derogate[13].

A detailed examination of these limitations is not germane to the research question at hand, and therefore not pursued here. However, the core idea that should be kept in mind going forward is the necessity of a balance between arbitral discretion on procedure and other interests including (a) agreement of parties (b) procedural fairness and certainty (c) consideration of time and cost efficacy and (d) other mandatorily applicable rules. As with procedural conduct, arbitral discretion plays a crucial function in many aspects of the investor-state arbitration process, within which we are chiefly concerned about the question of compensation and damages. The role of discretion in this regard is not about procedure, but a substantive determination involving the disputed claims and the rights of the parties in question. Therefore, a necessary distinction between procedural and 'substantive' arbitral discretion would have to be made going forward, considering the differences in their nature and scope of application. At the same time, procedural and substantive discretion can be fundamentally intertwined on many issues, such as in the recording and assessment of evidence in arbitration.

[12] Ibid 284
[13] Ibid 285-288

Before engaging in these questions examining the distinctions existing within arbitral discretion, it would be useful to conceptualise the nature of arbitral discretion. While commonly understood as a 'power' of arbitrators to make decisions based on their authority derived from the parties' agreement to arbitrate, it is necessary to differentiate discretion from other forms of powers exercised by arbitrators.

3. The Sources of Discretionary Powers of Arbitrators

The concept of arbitral powers, including discretionary powers, is closely tied to notion of the arbitrator's authority to make decisions. Without arbitral authority, the arbitral tribunal lacks the power to make decisions. For example, a tribunal that lacks jurisdiction to hear a dispute cannot adjudicate on the merits involved in such a dispute. The principal identity of the arbitrator is that of the adjudicator who is appointed by parties to resolve their disputes. Naturally, such an appointment entails a consent to decision-making by the arbitrator on the respective rights of the parties. Consequently, arbitrators are said to derive their authority from the consent of the parties to arbitrate, most commonly expressed in the form of an arbitration agreement[14]. By appointing an arbitrator based on their arbitration agreement, the parties in effect confer the authority necessary for the arbitrator to perform their functions. By agreeing to arbitrate, the parties also agree to bind themselves to the outcome of the arbitral process. The dual principles of party autonomy and consent are fundamental to the notion of arbitral authority and the powers derived on the basis of such authority.

Jan Paulsson observes in his influential book *The Idea of Arbitration*[15]:

> The idea of arbitration is that of binding resolution of disputes accepted with serenity by those who bear its consequences because of their special trust in chosen decision-makers.

It is understood that the choice of the parties to arbitrate also places an implicit faith in the authority of the appointed tribunal. But surely, there must be more than just the consent of parties that sustains the arbitral tribunal's authority? Paulsson differentiates the source of the tribunal's authority from the rules guiding their decision-making in the following manner:

[14] Sigvard Jarvin, 'The Sources and Limits of the Arbitrator's Powers' (1986) 2 Arbitration International 2, 140
[15] Jan Paulsson, *The Idea of Arbitration* (Oxford University Press 2014)

> The law applicable to arbitration is not the law applicable in arbitration. The latter provides norms to guide arbitrators' decisions. The former refers to the source of their authority and of the status of their decision: the legal order that governs arbitration[16].

The law applicable to arbitration provides legal legitimacy to the arbitral process. An arbitral tribunal that operates in violation of such law will not be considered to have the legal authority to conduct proceedings or make an award. On the other hand, an arbitral tribunal that is lawfully constituted will function in accordance with the rules applicable to the arbitral process: the law applicable *in arbitration*. Thus, there is a presumption of authority behind any discussion on the powers of arbitral tribunals. The exercise of arbitral discretion, if conceived as a power of arbitrators, would rest on such a presumption of authority. It would be useful to delve further into the concepts of authority and power in the arbitral context, in order to gain a clear understanding of where arbitral discretion lies.

3.1 Arbitral Authority

The powers of arbitrators to conduct proceedings and pass binding decisions in the form of arbitral awards have their basis on the idea of arbitral authority. The source of arbitral authority is the parties' agreement to arbitrate, with arbitration considered as a process firmly based on the principle of mutual consent[17]. The arbitration agreement defines the extent and limits of the arbitrator's authority, and also the conditions to the exercise of such authority[18]. In the arbitral process, jurisdiction of the arbitral tribunal is a *sine qua non* for the existence of arbitral authority.

The nature of the consent to arbitrate can vary in investor-State arbitration. International treaties, such as Bilateral Investment Treaties (BITs), create international legal obligations between States that are enforced through State-State arbitration or investor-State arbitration. The case of treaty-based investor-State arbitration is unique because the State's consent to arbitration exists as a standing offer to arbitrate made by each contracting State to foreign investors of the nationality of the other treaty signatories[19]. This standing offer is considered as accepted by the foreign investor's own consent to arbitrate through filing of a request for

[16] Ibid 29
[17] Justice James Allsop, 'The Authority of the Arbitrator' (2014) 30 Arbitration International 4, 639
[18] Ibid 640
[19] Guiguo Wang, 'Consent in Investor-State Arbitration: A Critical Analysis' (2014) 13 Chinese Journal of International Law 2, 335

arbitration against the host State. For such an eligible foreign investor, a prior arbitration agreement with the State is not necessary for the institution of arbitral proceedings. Since such modified consent is unique to it, investment treaty arbitration has been famously characterised as 'arbitration without privity'[20].

In the case of investment contracts signed between states and foreign investors, the identification of consent to arbitrate is more straightforward, as the arbitration clause is usually provided within the contract, or as a separate agreement. In some cases, contractual claims can also be elevated to treaty claims, subject to the provisions of the treaty in question[21]. Other sources for consent include national legislations or investment codes, containing a similar standing offer to arbitrate[22]. Despite the different manners of incorporation of consent, it is undisputed that the agreement to arbitrate is fundamental to the establishment of arbitral authority. As such, the consent of parties establishes arbitral authority in the form of jurisdiction to hear the dispute. The content of such jurisdiction, in the investor-State context, is specified by provisions of the principal legal instrument involved, be it either an investment treaty, contract or domestic law.

Investment treaties contain detailed provisions that define the scope of the arbitral tribunal's jurisdiction[23]. This includes eligibility conditions of investments and the type of disputes that can be raised (jurisdiction *ratione materiae*), conditions as to the parties who can be the subject of arbitral proceedings (jurisdiction *ratione personae*), along with temporal conditions regarding the investment and its related claims (jurisdiction *ratione temporis*)[24]. The two distinct questions regarding jurisdiction that are relevant to the assessment of arbitral authority are:

1. The *existence* of authority – Have the conditions necessary for vesting of adjudicative powers to the arbitral tribunal been satisfied? (*L'attribution de la juridiction*)
2. The *scope* of authority – What are the categories of parties and disputes regarding which the tribunal can adjudicate? (*L'étendue de la juridiction*)

[20] Jan Paulsson, 'Arbitration Without Privity'(1995) 10 ICSID Review 2, 232
[21] James Crawford, 'Treaty and Contract in Investment Arbitration, Treaty and Contract in Investment Arbitration' (2008) 24 Arbitration International 3
[22] Markus Burgstaller and Michael Waibel, 'Investment Codes' in Rüdiger Wolfrum (ed), *Max Planck Encyclopedia of Public International Law* (Oxford University Press 2012)
[23] Christoph Schreuer, 'Jurisdiction and Applicable Law in Investment Treaty Arbitration' (2014) 1 McGill Journal of Dispute Resolution 1
[24] Emmanuel Gaillard and Yas Banifatemi, *Jurisdiction in Investment Treaty Arbitration* (JurisNet 2018)

For *existence* of arbitral authority, consent is the most essential pre-condition. It must be noted that States do not provide an unqualified consent to arbitrate but place certain pre-conditions that must be met by the disputing foreign investor for the constitution of a valid consent. An essential condition is the existence of an eligible investment made or proposed to be made by a qualified investor as defined by the applicable treaty provisions[25]. The importance of this requirement lies simply in the fact that a dispute cannot be raised by those who do not qualify as investors for that which cannot be considered as investment under the applicable treaty provisions. Most investment treaties define such qualified investors and investments that serve as pre-conditions. For instance, Article 1.2 of the Netherlands-China Bilateral Investment Treaty[26] defines an 'investor' as follows:

> The term "investor" means, (a) natural persons who have nationality of either Contracting Party in accordance with the laws of that Contracting Party; (b) economic entities, including companies, corporations, associations, partnerships and other organizations, incorporated and constituted under the laws and regulations of either Contracting Party and have their seats in that Contracting Party, irrespective of whether or not for profit and whether their liabilities are limited or not.

This creates a necessary implication that any investor seeking to pursue arbitration must conform to the criteria provided in the definition for the tribunal to have jurisdiction *rationae personae*. Consequently, an arbitral tribunal in determining jurisdiction would inquire into the eligibility of the investor under the relevant treaty provisions, whether in hearing an objection to jurisdiction by the respondent State or *proprio motu*[27]. Other pre-conditions may also be specified in the relevant investment treaty or contract, such as the waiver of local remedies[28], mandatory waiting periods[29] etc. But for the present purposes, it may be considered that consent and the eligibility of the investor and their investment are fundamental pre-conditions to the establishing arbitral authority in investor-State arbitration.

Similarly, the *scope* of arbitral authority is circumscribed by the manner in which consent to arbitration and related pre-conditions are shaped by treaty or contract provisions[30]. Let us

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[25] Zachary Douglas, *The International Law of Investment Claims* (Oxford University Press 2009) 143

[26] Agreement on encouragement and reciprocal protection of investments between the Government of the People's Republic of China and the Government of the Kingdom of the Netherlands (signed 26 December 2001, entered into force 1 August 2004)

[27] Rule 41(2) of the ICSID Arbitration Rules permits the arbitral tribunal to consider at its own initiative as to whether it has the jurisdiction to hear a dispute or ancillary claims.

[28] Borzu Sabahi, Noah Rubins and Don Wallace Jr., *Investor-State Arbitration* (Oxford University Press 2nd ed. 2019) 118

[29] Ibid 115

[30] Douglas (n 25) 145

consider how this works with respect to jurisdiction *ratione materiae*. In such cases, consent is provided in the treaty text in such as manner as to limit the type of claims that can be submitted to arbitration, and thereby defines the scope of the arbitral tribunal's powers to adjudicate claims. For instance, certain BITs limit the scope of consent to dispute resolution only for breaches of specific treaty provisions. Article 3.1.1 of the EU-Singapore Investment Agreement defines the scope of dispute settlement as applicable to a dispute occurring between a claimant of one Party and the other Party concerning treatment that has been alleged to breach the provisions Investment Protection chapter of the Agreement.[31] Further, the breach must have allegedly caused loss or damage to the claimant or its locally established company.

As evident from the provision, the dispute settlement mechanism is only made available for the breach of the investment protection standards contained in Chapter 2 of the EU-Singapore Agreement. For the breach of treaty provisions outside Chapter 2, an arbitral tribunal would lack jurisdiction to the adjudicate the dispute. Such limited consent is fairly common in recent investment treaties that can be contrasted with older BITs providing a much wider scope of consent to dispute settlement. For example, the Netherlands-Bangladesh BIT defines the scope for consent to dispute settlement under wide terms in Article 9 to include "any legal dispute" arising between the host State and a national of the other home State[32].

By defining the scope of consent as 'any legal dispute' concerning an investment, the BIT clearly confers wide jurisdiction to an arbitral tribunal to hear a dispute. The tribunal's authority would be constructed extensively to adjudicate over any form of a legal dispute related to the investment, possibly also covering underlying contractual claims. Such broad scope of consent was typical of BITs that were signed between developed and developing countries during the 1990s[33]. As with the continuing evolution of the investment treaty regime, the narrowing of the scope of consent marks an increasing preference among States to tighten controls on the type of cases that can be brought to arbitration[34].

[31] Investment Protection Agreement between the European Union and its Member States, of the One Part, and the Republic of Singapore, of the other Part (signed 15 October 2018)
[32] Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the People's Republic of Bangladesh (signed 1 November 1994, entered into force 1 June 1996)
[33] Jose E. Alvarez and Karl P. Sauvant, *The Evolving International Investment Regime: Expectations, Realities, Options* (Oxford University Press 2011)
[34] United Nations Conference on Trade and Development (UNCTAD), *Investor-State Dispute Settlement*: *UNCTAD Series on Issues in International Investment Agreements II* (United Nations 2014) 31 <https://unctad.org/en/PublicationsLibrary/diaeia2013d2_en.pdf>

The discussion so far has been with respect to the construction of the proper legal authority of an arbitral tribunal, as expressed in terms of the *existence* and *scope* of its jurisdiction. However, another crucial element to arbitral authority is that of 'admissibility', often discussed in conjunction with jurisdiction. The principal distinction between jurisdiction and admissibility is that the former determines the legal authority of an arbitral tribunal to adjudicate a dispute, while the latter deals with the power of the tribunal to decide a case at a particular point in time owing to defects in the claim[35]. Both concepts shape the contours of arbitral authority, but in different ways. While jurisdiction delineates the more general legal authority of an arbitral tribunal as constituted under a treaty or contract, admissibility is concerned with specific claims at hand and whether they are 'fit and proper' to be adjudicated upon by the tribunal. Therefore, a tribunal would have no authority to adjudicate a claim or a dispute which it finds to be inadmissible. The often-cited distinction was given by Fitzmaurice in his study on the International Court of Justice as follows:

> an objection to the substantive admissibility of the claim is plea that the tribunal should rule the claim inadmissible on some ground other than its ultimate merit; an objection to the jurisdiction of the tribunal is a plea that the tribunal itself is incompetent to give any ruling at all whether as to the merits or as to the admissibility of the claim.[36]

The conditions of admissibility are distinct from the conditions for jurisdiction of an international court or tribunal. Even though a court may have proper jurisdiction to adjudicate a dispute between parties, the inadmissibility of a claim may bar any exercise of adjudication on its merits[37]. This was well brought out by the ICJ in the *Oil Platforms* where it observed that even if the Court has jurisdiction, an objection to admissibility seeks to assert why the Court should not proceed with an examination of the merits of the case.[38]

In investor-state arbitration, there is a certain fluidity between the issues of jurisdiction and admissibility, with both often addressed together under preliminary objections by arbitral tribunals[39]. Neither the ICSID Convention (including ICSID Arbitration Rules) nor the

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[35] Michael Waibel, 'Investment Arbitration: Jurisdiction and Admissibility' (2014) Cambridge Faculty of Law Legal Studies Research Paper Series No. 9/2014 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2391789>
[36] G. Fitzmaurice, *The Law and Procedure of the International Court of Justice* (Grotius 1986) 434–40
[37] Jan Paulsson, 'Jurisdiction and Admissibility, Global Reflections on International Law' in Gerald Aksen (ed.), *Commerce and Dispute Resolution: Liber Amicorum in honour of Robert Briner* (ICC Publishing 2005) 605-608
[38] *Oil Platforms (Iran v. USA*), Judgment, ICJ Rep. 2003, 161, para. 29.
[39] Veijo Heiskanen, 'Menage a` trois? Jurisdiction, Admissibility and Competence in Investment Treaty Arbitration' (2014) 29 ICSID Review 1, 231

UNCITRAL Arbitration Rules refer to admissibility. Consequently, arbitral tribunals have been reluctant to make clear demarcations between jurisdiction and admissibility[40].

Despite the reluctance of some tribunals to examine the conceptual differences, arbitral tribunals have in the past held distinctive inquiries into objections regarding jurisdiction and admissibility[41]. For the present purposes, admissibility requirements may be considered as limitations to the exercise of arbitral authority to hear a dispute. As with jurisdiction, admissibility issues can also be defined in terms of subject matter (*rationae materiae*), persons (*rationae personae*) and time (*rationae temporis*)[42]. However, the application of admissibility and its consequences for a dispute are markedly different. The differences in inquiry on the basis of jurisdiction and admissibility are illustrated as follows:

Scope of arbitral authority	**Jurisdiction**	**Admissibility**
Subject Matter (*rationae materiae*)	Which type of claims can be subject to arbitration?	Are there any defects (e.g. illegality) in the subject investment on which the claim is based?
Persons (*rationae personae*)	Who can submit claims to arbitration?	Does the investor fulfil the nationality requirement to be considered eligible to raise the claim/dispute?
Temporal (*rationae temporis*)	When did the obligations enter into force?	Has the claimant fulfilled the requirement to resort to domestic remedies before proceeding with arbitration?

It is apparent that questions of admissibility, though closely tied to jurisdiction, are directed towards the claims in question. Once jurisdiction is established, an arbitral tribunal can filter

[40] See for instance, *Pan American Energy LLC and BP Argentina Exploration Company v Argentine Republic*, ICSID Case No ARB/03/13, Decision on Preliminary Objections (27 July 2006) 54
[41] *Methanex Corporation v. United States of America*, Preliminary Award on Jurisdiction and Liability, (7 August 2002); *SGS Societe Generale de Surveillance SA v Republic of the Philippines*, ICSID Case No ARB/02/06, Decision on Objections to Jurisdiction (29 January 2004)
[42] Heiskanen (n 39) 236

admissible claims from those with defects. The arbitral process itself does not get upended if only certain claims are inadmissible. However, if the arbitral tribunal lacks fundamental authority in terms of jurisdiction, there is no question of continuing the arbitral proceeding. As per Arbitrator Keith Highet's dissenting opinion in *Waste Management v. Mexico,* jurisdiction comprises of the power of the tribunal to hear the case. On the other hand, admissibility is concerned with whether the case itself is defective and if the arbitral tribunal should act. Admissibility can only be considered after jurisdiction of the tribunal is confirmed.[43]

A question here can be raised as to the *scope* of admissibility. As with jurisdiction, the scope of admissibility will be largely defined by the treaty/contract/national law provisions contained in the respective instrument. In the determination of the admissibility of a claim, the arbitral tribunal will first look at the conditions set in such instruments. Often, procedural pre-conditions might concern issues of admissibility and jurisdiction, causing significant overlapping of issues. This may lead to confusion over whether non-compliance of such pre-conditions or prerequisites would lead to a failure of admissibility or jurisdiction. According to Waibel, these procedural perquisites form an intermediate category. However, the key question for the tribunal is whether such prerequisites have been formulated as a condition for consent. Mandatory conditions can be regarded as concerning the tribunal's jurisdiction, whereas other procedural prerequisites concern the admissibility of a particular claim**.**[44]

The necessity for arbitral tribunals to carefully interpret such prerequisites is quite self-evident, given the incentives for the respondent-state to characterise all of these as mandatory. Jurisdictional non-conformity would be pathological to the arbitral process itself, while a failure of admissibility is a temporal problem which the claimant can attempt to overcome by removing the defects in the claim. The problem is well characterised by the example of waiting period clauses that are common in most BITs and other legal instruments. Waiting period clauses, also referred to as "cooling off" clauses, require the Claimant-investor to wait for a certain period of time between the government act triggering the dispute and the commencement of arbitration[45]. Commonly, the specified period is for six months, though it may vary considerably depending on the applicable provision. Waiting period clauses are of two types: (i) clauses that encourage the disputing parties to engage in conciliation, negotiation

[43] *Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/98/2, Dissenting Opinion Arbitrator Highet para 58
[44] Waibel (n 35) 71
[45] Borzu Sabahi (n 28) 115

or diplomatic means in order to amicably settle the dispute; or (ii) pursue remedies in domestic courts or administrative tribunals.

There has been considerable disagreement among arbitral tribunals in the interpretation of waiting period clauses. Principally, the disagreement is regarding whether non-compliance with waiting period requirements bars the jurisdiction of an arbitral tribunal or if it leads to an inadmissible claim until such defects are cured[46]. While some tribunals have held such clauses as prerequisites to jurisdiction[47], others have considered them as merely procedural requirements that can be dispensed with at the tribunal's discretion[48]. For instance, in the case of *Ronald S. Lauder v. Czech Republic*, the treaty-defined six-month waiting period was found by the tribunal as a requirement that meant to allow the parties to engage in good-faith negotiations before initiating arbitration[49]. However, the tribunal held that the use of such a clause to halt the initiation of arbitration proceedings for a full six-month period could amount to an "unnecessary, overly formalistic approach" which would not serve the interests of any disputing party. Considering the particular fact of the case, the tribunal held that the requirement of the six-month waiting period did not preclude it from having jurisdiction in the proceedings[50].

The characterisation of strict adherence to waiting periods as an "overly formalistic" approach gained traction among later tribunals, with waivers becoming increasingly common in cases with lengthy waiting periods or other onerous prerequisites. However, with several other tribunals having reached the opposite conclusion in denying jurisdiction due to non-fulfilment of waiting periods, the debate cannot be said have been settled definitively. A more relevant question that seems to emerge here is regarding the classification of waiting period clauses as requirements of jurisdiction or admissibility. If considered as a prerequisite to jurisdiction,

[46] Christer Soderlund and Elena Burova, 'Is There Such a Thing as Admissibility in Investment Arbitration?' (2018) 33 ICSID Review 2

[47] *Burlington Resources v. Republic of Ecuador*, ICSID Case No. ARB/08/05, Decision on Jurisdiction (2 June 2010) 312; *Murphy Exploration & Production Company International v. Republic of Ecuador*, ICSID Case No. ARB/08/4 Decision on Jurisdiction (15 December 2010) 148; *ICS Inspection and Control Services Limited (United Kingdom) v. The Republic of Argentina*, UNCITRAL, PCA Case No. 2010-9, Award on Jurisdiction (10 February 2012) 245; *Kiliç İnşaat İthalat İhracat Sanayi Ve Ticaret Anonim Şirketi v. Turkmenistan*, ICSID Case No. ARB/10/1, Award (2 July 2013) 6.3.2

[48] *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) 343; *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011) 564; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction (2 August 2003) 184; *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan*, SCC Case No. V 116/2010, Award (19 December 2013) 829;

[49] *Ronald S. Lauder v. The Czech Republic*, UNCITRAL Arbitration, Award (3 September 2001) para 187

[50] Ibid para 190

arbitral tribunals have little leeway in proceeding with a dispute where a party does not fulfil the waiting period requirement. But when considered as an issue of admissibility, an arbitral tribunal can seemingly exercise greater procedural discretion to address the non-fulfilment of the waiting period requirement. By framing the issue as a procedural prerequisite to admissibility instead of jurisdiction, tribunals need to address only a defective claim instead of a lack of authority that cannot be corrected as easily[51]. In fact, the majority tribunal in *İçkale İnşaat Limited Şirketi v. Turkmenistan* followed that argument by re-framing objections to jurisdiction on the ground of breach of waiting period requirements as an issue of admissibility. The objection to jurisdiction was in the context of Article VII(2) of the Turkey-Turkmenistan BIT, which contained a domestic litigation requirement prior to arbitration that had not been fulfilled by the Claimant-investor. Even though both of the disputing parties presented their arguments to the objection as an issue of jurisdiction, the tribunal disagreed that it was a question of jurisdiction. After considering the applicable legal framework, the tribunal held that it was not bound by the disputing parties shared legal position[52]. Referring to its own authority under the ICSID Convention to decide whether the non-compliance was an issue of jurisdiction or admissibility, the tribunal held that Article VII(2):

> ..does not concern the issue of whether the State parties have given their consent to arbitrate – they have – but rather the issue of how that consent is to be invoked by a foreign investor; as an issue of "how" rather than "whether," it must be considered a matter of procedure and not as an element of the State parties' consent. Consequently, any objection raised on the basis of alleged non-compliance by an investor with any of the required procedural steps must be characterized as an objection to the admissibility of the claim rather than as an objection to the tribunal's jurisdiction.[53] (emphasis added)

The tribunal then went on to hold that it would be inappropriate at the stage to require the Claimant-investor to first submit the dispute to local courts and that the claimant's claims must be considered admissible[54]. This was based on the Tribunal's finding that certain court proceedings that had earlier been initiated by the State agencies against the Claimant satisfied the local remedies requirement of the BIT, as these court proceedings largely involved the same subject at issue as the investor-State arbitration[55].

[51] Soderlund and Burova (n 46) 525
[52] *İçkale İnşaat Limited Şirketi v. Turkmenistan*, ICSID Case No. ARB/10/24, Award (8 March 2016) 239
[53] Ibid para 242
[54] Ibid para 263
[55] Ibid para 262

Despite continuing disagreements among tribunals regarding their application, it is widely accepted that jurisdiction and admissibility conditions circumscribe scope of arbitral authority. While jurisdiction pertains to the fundamental idea of adjudicative authority of a tribunal, admissibility seeks to place a particular claim-specific limit to such authority. However, investor-state tribunals prefer to address these issues together under preliminary objections. As observed in certain cases, tribunals may sidestep procedural prerequisites to jurisdiction by re-framing them as conditions to admissibility. This opens up greater discretionary space for the arbitrator to admit or reject the claims. In the absence of a rule-based definition of admissibility, it exists as a flexible concept that may be interpreted in various ways by an arbitral tribunal. Consequently, applying the test of admissibility rather than jurisdiction on certain treaty-based requirements may legitimize a degree of discretion to tribunal, that may come at the risk of consistency and predictability[56]. This is an issue that we will encounter throughout this thesis, where the lack of explicit rules or definitions creates such areas of discretionary flexibility, enabling arbitral tribunals to make decisions that may not reflect the intent of the parties drafting the investment treaty.

Arbitral tribunals have made ample use of the powers available under investment treaties and arbitration rules to overcome procedural barriers to their authority. In the *İçkale* award, the majority tribunal referred to the principle of *Kompetenz-Kompetenz*, which dictates that an arbitral tribunal has the competence to determine its own jurisdiction, even though it chose to turn a question of jurisdiction into a question of admissibility[57]. Tribunals use this flexibility provided by such principles of arbitration to take an approach that they find most suitable to a given dispute, even though it may not follow from established arbitral practice. The next section examines some of the broader features of arbitral powers regarding substantive and procedural issues in investor-State arbitration. These powers are numerous, and it is not possible to assess every aspect in detail. Therefore, the section will focus mainly on the issue of discretionary powers as the principal subject matter of this research project.

3.2 Arbitral Powers

So far, we have noted the centrality of consent and its various prerequisites towards establishing the scope of arbitral authority. After the due constitution of a tribunal, the regulation of arbitral

[56] Soderlund and Burova (n 46) 559
[57] *İçkale v. Turkmenistan* (n 52) para 239

authority continues with the application of limitations to the powers of the arbitral tribunal. Here, power is understood as a corollary to arbitral authority - the legal right of an arbitral tribunal to act in pursuance of such authority. Therefore, arbitral powers are a corollary to the adjudicative authority of arbitrators[58]. These powers are not separately delineated in investment treaties or arbitration rules. Instead, the provisions of such applicable legal instruments collectively define their scope. Firstly, as the exercise of powers is dependent on the existence of arbitral authority, the consent of the parties is a crucial factor in the determination of arbitral powers. Secondly, the applicable law in arbitration proceedings is an equally important source of such powers. The sources of arbitral powers include the *arbitration agreement* (whether as a treaty, contract or national law on foreign investment), the *arbitration rules* as selected by the parties along with the law of the seat (or legal place) of the arbitration, known as *lex arbitri*[59].

As the concepts of consent and authority have already been discussed in the previous section, they are not repeated here. As the consent of parties defines the existence and scope of arbitral authority, arbitral powers are consequently derived from such authority. For example, if an investment treaty limits the authority of a tribunal to only adjudicate disputes relating to expropriation of property, the tribunal cannot exercise its powers to adjudicate disputes arising from other causes of action. However, consent to arbitration only goes so far as defining the manner in which arbitral authority is to be organised. The applicable law provides structure to the arbitral process and its outcome. Therefore, the implications of the terms of the arbitration agreement, the applicable arbitration rules, along with *lex arbitri* are examined in the following sub-sections.

3.2.1 The Arbitration Agreement

The prerequisites to the grant of consent in investment treaties has already been described as the determinants of the existence and scope of arbitral authority. Most agreements (investment treaties, contracts or domestic laws on foreign investment) do not seek to constrain arbitral powers directly. Instead, parties to the agreement select the procedural rules of arbitration that provide a more detailed framework for the exercise of arbitral authority. However, certain

[58] Andrea K. Bjorklund and Jonathan Brosseau, 'Sources of Inherent Powers', in Franco Ferrari and Friedrich Rosenfeld (eds.), *Inherent Powers of Arbitrators* (JurisNet 2019)
[59] Sabahi et al. (n 28) 113

aspects of the dispute settlement process are bound by the agreement directly, indicating a desire among contracting parties to place adequate controls on decision-making. At the first step, it has been noted how parties can include certain prerequisites regarding the types of disputes that can be admitted to arbitration, and various waiting periods associated with them. Broadly, these can be categorised as factors limiting the access to arbitration[60]. Their effect on the arbitral tribunal's powers lies as limits to the tribunal's authority to adjudicate a dispute. Limitation periods are also frequently incorporated into the arbitration agreement, placing a temporal limited to claims starting from when the claimant-investor first acquired knowledge of breach of the agreement by the host State[61].

Following consent, the agreement of parties also extends to govern certain issues of *conduct* of proceedings. The relevant provisions may supplement, derogate from or fill gaps in the applicable procedural rules of arbitration[62]. Firstly, an arbitral tribunal is required to settle disputes only within the ambit of the applicable law as provided in the investment agreement. In treaties, applicable law is usually a combination of the substantive treaty provisions, principles of international law applicable between the treaty parties, and domestic law of the respondent-State where the investment was made[63]. For instance, the applicable law provision under Article 3.42.2 of the EU-Viet Nam Investment Protection Agreement states:

> When rendering its decisions, the Tribunal and the Appeal Tribunal shall apply the provisions of Chapter 2 (Investment Protection) and other provisions of this Agreement, as applicable, as well as other rules or principles of international law applicable between the Parties, and take into consideration, as matter of fact, any relevant domestic law of the disputing Party[64].

The applicable law provision, therefore, constrains the tribunal in its decision-making from travelling beyond the substantive legal framework as agreed by the parties. Issues of interpretation are similarly addressed by reference to the specific rules with, which tribunals must abide, which in treaty-based arbitration is usually the Vienna Convention on the Law of Treaties ('Vienna Convention')[65].

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[60] UNCTAD (n 34) 31

[61] For instance, Article 26 of the United States Model BIT of 2012 placed a three-year limitation on claims starting from the date on which knowledge of the breach was first acquired.

[62] Sabahi et al. (n 28) 115

[63] Andrea K. Bjorklund, 'Applicable Law in International Investment Disputes' in Chiara Georgetti (ed.), *Litigating International Investment Disputes: A Practitioner's Guide* (Brill 2014) 261

[64] Investment Protection Agreement between the European Union and its Member States and the Socialist Republic of Viet Nam (signed 30 June 2019, yet to be ratified)

[65] Vienna Convention on the Law of Treaties, done at Vienna on 23 May 1969 United Nations, Treaty Series, vol. 1155, p. 331

Secondly, parties may agree to direct an appointed tribunal to consider certain issues at a preliminary stage of proceedings and within a specified time-frame. This could be while handling preliminary objections invoking the lack of any legal merit, or against claims allegedly unfounded as a matter of law[66]. The mandate given by the parties to the arbitral tribunal to handle such objections at a preliminary stage is purportedly aimed at achieving time and cost-efficiency in handling frivolous claims[67]. Another crucial aspect dealt with in this regard is that of transparency of proceedings and the participation of third parties (including public interest) in disputes, an issue that has gained great relevance in recent years[68]. Several new-generation investment treaties have incorporated the 2014 UNCITRAL Transparency Rules[69], and placed a requirement on arbitral tribunals to conduct public hearings and making certain documents of the proceedings publicly accessible, subject to conservation of protected information[70]. On the issue of *amicus curiae* briefs, investment treaties as well as arbitration rules leave it to the discretion of the arbitral tribunals on whether to accept such submissions. Certain conditions in terms of timeframe of submission, length of document etc. may also be mandated by treaty provisions. For example, Annex 9 (Rules of Procedure for Arbitration) of the EU-Singapore Investment Protection Agreement provides conditions on *amicus curiae* submissions as : (1) they must be made within ten days of the date of the establishment of the arbitration panel, (2) they must be concise and not longer than 15 typed pages and that (3) they must have direct relevance to the factual issue under consideration by the arbitration panel.[71]

In the same vein, some countries also seek to incorporate provisions enabling arbitral tribunals to appoint experts to the tribunal to seek their opinion of certain technical or scientific issues, subject to there being no disapproval of the disputing parties. The Indian Model BIT prescribes such a provision as:

> Without prejudice to the appointment of other kinds of experts where authorized by the applicable arbitration rules, and unless the disputing parties disapprove, a Tribunal may appoint experts to

[66] Article 3.45, EU-Vietnam Investment Protection Agreement
[67] Michele Potestà and Marija Sobat, 'Frivolous Claims in International Adjudication: A Study of ICSID Rule 41(5) and of Procedures of Other Courts and Tribunals to Dismiss Claims Summarily' (2012) 3 Journal of International Dispute Settlement 1, 137
[68] Alessandra Asteriti and Christian J. Tams, 'Transparency and Representation of the Public Interest in Investment Treaty Arbitration' in Stephan W. Schill, *International Investment Law and Comparative Public Law* (Oxford University Press 2010)
[69] UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, UN General Assembly Resolution A/RES/68/109 (16 December 2013)
[70] See Article 29, 2012 US Model BIT
[71] Investment Protection Agreement between the European Union and its Member States, of the One Part, and the Republic of Singapore, of the other Part (signed 15 October 2018)

report to it in writing on any factual issue concerning environmental, health, safety, technical or other scientific matters raised by a disputing party, subject to such terms and conditions as the disputing parties may agree.[72]

Thirdly, clauses governing the making of awards may restrict the remedies that can be awarded by arbitral tribunals. Provisions governing the making of arbitral awards indicate the agreement among contracting parties to limit the type of remedies that may be awarded by arbitral tribunals. This could be in terms of monetary compensation, restitution of property or other specific measures[73]. For instance, Article 14.D.13.1 of the United States-Mexico-Canada Agreement (USMCA) authorises arbitral tribunals to make separate or combined awards providing for monetary damages with interest or restitution of property, although such restitution must come with the option for the respondent to pay damages in lieu of such restitution[74]. Such clauses have gained prominence in many modern investment treaties, with arbitral tribunals resorting to pecuniary remedies as the principal form of granting relief.

Although restitution is considered as the primary remedy in international law, investment tribunals have historically held a preference for monetary compensation in lieu of restitution of property[75]. This has been ascribed to a number of reasons, including the fact that restitution may not be permitted under domestic law, the property may have been destroyed/modified or the legal title may have passed to other persons[76]. In the ILC's Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA), Article 35 provides a way out for States to provide restitution in two situations: where restitution is *materially impossible*, or where it would impose a *disproportionate burden* on the State[77]. Provisions such as Article 14.D.13.1 of the USMCA seek to avoid a situation where arbitral tribunals would need to consider these issues by circumscribing arbitral powers of restitution.

It is important to note that such restrictions of remedies are found in a fairly small number of investment treaties in force. In a large sample survey of investment treaties conducted in 2012 by the Organisation on Economic Co-operation and Development (OECD), it was found that

[72] Article 25, Model Text for the Indian Bilateral Investment Treaty, (approved 28 December 2015) <https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf>
[73] Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (Oxford University Press 2017)
[74] Agreement between the United States of America, the United Mexican States, and Canada (signed 30 November 2018, entered into force 1 July 2020)
[75] Borzu Sabahi, Restitution, in *Compensation and Restitution in Investor-State Arbitration: Principles and Practice* (Oxford University Press 2011) 62
[76] Ibid 86-87
[77] International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Yearbook of the International Law Commission*, 2001, (Vol. II Part Two) 96-97

fewer than 10% contained any treaty language on remedies[78]. It was noted that provisions on remedies would contain positive or negative lists of remedies that could be awarded by arbitral tribunals. Positive lists would usually include remedies such as declaratory awards, compensation, interest, restitution of property, allocation of costs and fees etc. On the other hand, negative lists would restrict tribunals from awarding punitive damages, awards other than monetary damages, and compensation greater than specified by treaty standards, among others[79]. In 2018, UNCTAD in its Reform Package for the International Investment Regime noted the lack of treaty guidance on the award of remedies as an issue of concern for States[80]. The report highlighted two concerns in particular: (i) the affirmation of wide powers by arbitral tribunals to grant any remedy, and (ii) grant of exorbitant monetary awards in light of the State's public finances and compared to what would be granted under domestic rules. It was suggested that States could engage in certain treaty-based reforms in order to restrict the remedies that could be awarded by tribunals and setting standards for calculation of compensation and damages[81].

In recent years, an increasing number of investment agreements have incorporated provisions placing restrictions on remedies (as noted with the USMCA) and others that seek to guide the assessment of compensation and damages. For instance, the EU's new-generation economic agreements with Canada, Viet Nam and Singapore have incorporated certain clauses that address the issue of double recovery of damages. Article 8.39.3 of the CETA between Canada and EU states that monetary damages shall not be greater than the loss suffered by the investor and must be reduced by any prior damages or compensation that has already been provided. The Tribunal shall also reduce the damages to account for any restitution of property or repeal or modification of the measure[82]. While it does not place any express guidance on the calculation of damages, the provision seeks to restrict unfair enrichment of claimant-investors by way of double recovery[83]. An investment tribunal must deduct any damages already received by the investor in respect of the dispute in question. A similar provision is also

[78] Kathryn Gordon Joachim Pohl and Kekeletso Mashigo, 'Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey' (OECD 2012) 30 <http://www.oecd.org/investment/internationalinvestmentagreements/50291678.pdf>
[79] Ibid 31
[80] James X. Zhan et al., UNCTAD's Reform Package for the International Investment Regime, (UNCTAD 2018) 46 <https://investmentpolicy.unctad.org/uploaded-files/document/UNCTAD_Reform_Package_2018.pdf>
[81] Ibid.
[82] Comprehensive Trade and Economic Agreement between Canada and the European Union (signed 30 October 2016, investment chapter not in force)
[83] Irmgard Marboe, 'Assessing Compensation and Damages in Expropriation versus Non-expropriation Cases' in Christina Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 117

espoused by the 2015 Indian Model BIT, but which also directs arbitral tribunals to reduce damages on additional considerations for 'mitigating factors'. These include current and past use of the investment, the history of its acquisition and purpose, compensation received by the investor from other sources, any unremedied harm or damage that the investor has caused to the environment or local community or other relevant considerations regarding the need to balance public interest and the interests of the investor[84]. The Indian text therefore provides wider scope for an arbitral tribunal to reduce or adjust the damages awarded.

Another treaty innovation that has been incorporated in recent treaties as a limitation on damages is that of capacity. Introduced during the negotiations of the Trans-Pacific Partnership (TPP), the provision seeks to restrict the amount of damages awarded by requiring arbitral tribunals to compensate claimants only in their capacity as investors. For example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a successor to the abandoned Trans-Pacific Partnership Agreement, incorporates a provision under Article 9.29.2 that a claimant may recover losses or damages that it has incurred only in its capacity as an investor. This capacity limitation is largely aimed at ensuring that claimant-investors are not compensated for damages incurred outside their primary role as 'investors' in the host State. Therefore, damages incurred by the investor or their subsidiaries strictly in their role as exporters, service providers etc. shall not be compensated under damages awards[85]. The same provision has been incorporated into the USMCA[86] and also in the recent EU investment agreement with Viet Nam[87] and in the negotiation texts with Mexico[88]. This would consequently limit the possible Claimants as well as the quantum of compensation that could be claimed in arbitration.

International investment agreements, therefore, seek to constrain arbitral powers in some common ways. With the rapid expansion in the number of treaties and other investment instruments over the past three decades, there has been a greater diffusion of common norms and provisions in the treaty texts[89]. While most investment treaties circumscribe arbitral powers in a largely uniform manner, certain differentiations may also emerge. Ongoing discussions on

[84] Article 26.3, 2015 Indian Model BIT (n 72)
[85] Mark Feldman, 'Multinational Enterprises and Investment Treaties', in L. Sachs and L. Johnson, (eds.) *Yearbook on International Investment Law & Policy 2015-2016* (Oxford University Press 2018)
[86] Article 14.D.13.3 USMCA
[87] Article 3.53.3 EU-Viet Nam Investment Protection Agreement
[88] Article 29.4, Modernisation of the Trade part of the EU-Mexico Global Agreement (agreement in principle announced on 21 April 2018)
[89] Chester Brown, 'The Cross-Fertilization of Principles Relating to Procedure and Remedies in the Jurisprudence of International Courts and Tribunals' (2008) 30 Loyola International & Comparative Law Review 219

investment treaty reform in forums, such as UNCTAD, suggests that States are making greater efforts towards exerting control over treaty standards and the dispute settlement process[90]. The resultant effect on the scope of arbitral powers will thereby continue to evolve over time.

3.2.2 Procedural Rules of Arbitration

The choice of applicable procedural rules of arbitration is usually subject to the agreement of disputing parties. In international investment agreements, the prior consent of States to arbitration also includes an offer to arbitrate under specific procedural rules delineated in the treaty or agreement[91]. When investors submit a claim for arbitration, they must choose among the different procedural rules available in the investment agreement. Most agreements provide a choice among the ICSID Convention (including ICSID Arbitration Rules), the ICSID Additional Facility Rules, and the UNCITRAL Arbitration Rules. The option to refer to the procedural rules of major arbitral institutions like ICC, LCIA or SCC may also be provided in some agreements. Additionally, they may also permit the claimant-investor and the respondent-host State to choose by mutual consent the appropriate arbitration rules that would be applicable to the dispute. Broadly speaking, these varied procedural rules of arbitration provide a complete structural framework to the arbitration process, starting with the establishment of an arbitral tribunal, its conduct and functioning, up to the making of the arbitral award. The ICSID Convention and Arbitration Rules, which aim to provide a more comprehensive, self-contained system for investor-State dispute settlement, expand their ambit further to incorporate procedures involved in post-award remedies like annulment.

The procedural powers of arbitrators are embedded throughout the extensive rules incorporated under the various procedural rules. As such, it will be beyond the scope of this research project to examine the content and implications of each of these provisions for the overall scheme of arbitral powers. Since we are chiefly concerned here about procedural powers and their relationship to the determination of compensation and damages, this sub-section will provide an overview of the procedural framework that underpins the decision-making process. Therefore, the following sub-section will delineate the procedural rules governing the merits

[90] UNCTAD, The Changing IIA Landscape: New Treaties and Recent Policy Developments, IIA Issues Note (1 July 2020) <https://investmentpolicy.unctad.org/publications/1230/the-changing-iia-landscape-new-treaties-and-recent-policy-developments>

[91] Christopher F. Dugan, Don Wallace, Jr., Noah Rubins, Borzu Sabahi, *Investor-State Arbitration* (Oxford University Press 2008)

of a dispute, along with the taking of evidence (including expert evidence). The discussion on procedural rules is kept limited to the ICSID and UNCITRAL systems, which have accounted for over 90% of the known investor-State cases overall[92]. The import of these provisions will be discussed in greater detail in the succeeding chapters of this research thesis.

A. Procedural rules governing merits

The decision-making role of arbitral tribunals is the central function for which they are appointed. While investment treaties and arbitration rules seek to provide complete freedom to arbitral tribunals in determining the outcomes of disputes, certain procedural rules are made applicable for the protection of the rights and interests of the disputing parties. Article 42 of the ICSID Convention is the central provision that guides arbitral tribunals in this regard. The first question that is dealt with under Article 42(1) regarding the legal basis on which arbitral tribunals must decide the merits of a dispute[93]. The Article might also be termed as the 'applicable law' provision, which makes decision-making subject to the rules of law chosen by the parties to the arbitration agreement[94]. This implies that the applicable law provision as incorporated in an investment treaty or agreement would determine the basis on which the legal merits of a dispute are decided. As also noted earlier, most investment treaties incorporate an amalgam of treaty-based provisions, principles of international law and domestic law of the host State into the applicable law of the treaty. In cases where there is no prior agreement on applicable law, Article 42(1) takes over and directs the application of the domestic law of the respondent host-State in the dispute, along with applicable principles of international law. Thus, Article 42(1) seeks to have a similar effect as how applicable law rules are incorporated in the principal investment agreement[95].

The rule governing applicable law on merits is given in the UNCITRAL Arbitration Rules under Article 35(1). While at the first instance it defers the question of applicable law on merits to be determined by the agreement of parties, where such an agreement is absent, it directs the determination to be done by the arbitral tribunal[96]. Thus, in both procedural systems, party

[92] UNCTAD, 'Investor-State Dispute Settlement cases pass the 1,000 mark: Cases and outcomes in 2019', IIA Issues Note Issue No. 2 (July 2020) <https://unctad.org/en/PublicationsLibrary/diaepcbinf2020d6.pdf>
[93] Christoph Schreuer et al., *The ICSID Convention: A Commentary* (Cambridge University Press 2nd ed. 2009) 550
[94] Article 42(1) ICSID Convention.
[95] Schreuer et al. (n 93) 553
[96] See Article 35(1) of the UNCITRAL Arbitration Rules 2010

autonomy is given precedence at first instance, but in the absence of an agreement among the parties, they provide different solutions to the determination of applicable law. The UNCITRAL Rules provide greater discretion to arbitrators to decide the applicable law on merits, whereas the ICSID system prescribes the application of domestic law and applicable principles of international law.

Second, Article 42(2) of the ICSID Convention prohibits tribunals from issuing *non-liquet* findings based on silence or obscurity of the law. The prohibition is modelled on Article 11 of the International Law Commission's Model Rules of Arbitration Procedure[97]. It works on the assumption that the body of law that is applicable to a dispute under Article 42(1) is broad enough to answer any question of merit that may emerge in the arbitration[98]. Therefore, the provision seeks to prevent the frustration of the proceedings and the efforts of the disputing parties by mandating a determination to be reached by the arbitral tribunal. Where there is a gap or lacuna in the law, arbitral tribunals can implement a wide range of interpretive tools in order to fill the gaps in the law, via usage of broader legal principles, analogies, object and purpose and general principles of law, among others[99]. In contrast, the UNCITRAL Rules do not contain an express prohibition against *non-liquet* findings. In international arbitration, however, there remains a norm of avoiding such *non-liquet* findings, particularly considering that they leave disputants without any remedy or a means of obtaining redress[100].

Third**,** arbitration rules confer the authority on arbitral tribunals to decide a dispute *ex aequo et bono*, subject to the approval of the disputing parties. Both ICSID Convention (Article 42(3)) and UNCITRAL Arbitration Rules (Article 35(2)) enable *ex aequo et bono* decisions, permitting arbitral tribunals to decide in a manner that it considers to be fair and in good conscience[101]. Such decisions may involve extra-legal considerations, or on the basis of legal principles that are not usually applicable, given that these decisions are made on the basis of equity rather than law[102]. An important caveat is the necessity of agreement among the parties, without which an arbitral tribunal cannot decide *ex aequo et bono*. Such authorization may be

[97] ILC, Model Rules of Arbitration Procedure 1958, Yearbook of the International Law Commission (1958)
[98] Schreuer (n 93) 630
[99] Ibid.
[100] Sourgens et al. (n 5) 15
[101] Leon Trakman, 'Ex Aequo et Bono: Demystifying an Ancient Concept' (2008) 8 Chicago Journal of International Law 2
[102] Schreuer et al. (n 93) 632

given by the contracting parties in the arbitration agreement/treaty or by the disputing parties orally during the hearings[103].

The power to issue decisions *ex aequo et bono* is important, though it has found limited application in investment disputes so far. It provides a margin of discretion to arbitral tribunals to settle disputes and provide a satisfactory closure to disputing parties where the application of the applicable rules of law may be insufficient. In this respect, decisions based on equity need not necessarily avoid application of the rules of law. Arbitrators may apply the law as it is, derogate from it or apply rules which would not apply otherwise[104]. The powers of equity are not unlimited, however. The ICSID Convention requires arbitral tribunals to ensure fairness and objectivity in the award and must be supported by reasons, as required for decisions based on the rules of law[105]. Further, considerations for international public policy and *ius cogens* (pre-emptory norms of international law) shall limit arbitral discretion. In UNCITRAL arbitrations, the tribunal must also consider whether the *lex arbitri* or the law of the seat of arbitration permits the making of awards on the basis of *ex aequo et bono* decision-making[106]. While the ICSID Convention places no such requirements posed by domestic law, the ICSID Additional Facility Rules state that *ex aequo et bono* decisions must be permitted under the applicable law, in addition to an agreement among the parties[107].

Awards containing decisions passed on the basis of the *ex aequo et bono* principle are rare, with only two known cases dating back to the 1980s: *Benvenuti v. Congo*[108] and *Atlantic Triton v. Guinea*[109]. Interestingly, in both cases, the subject matter for the exercise of decision-making on equity was the amount of monetary compensation that was to be awarded, including the interest that was to be awarded on them. In the *Benvenuti* case, the parties had agreed to an award made *ex aequo et bono* during the proceedings before the arbitral tribunal. However, the agreement was subject to prior negotiations for settlement by *amiable compositeur*, which eventually failed[110]. Consequently, the quantum of damages under various heads were

[103] Caron and Cohen (n 11) 428
[104] Schreuer (n 93) 636
[105] Schreuer (n 93) 638
[106] The same is not necessary for arbitrations under the ICSID Convention as it is a self-contained system where law of the seat of arbitrations do not apply. See, Sabahi et al. (n 28) 115
[107] Article 54(2) ICSID Additional Facility Rules 2006: "The Tribunal may decide ex aequo et bono if the parties have expressly authorized it to do so and if the law applicable to the arbitration so permits"
[108] *S.A.R.L. Benvenuti & Bonfant v. Government of the People's Republic of the Congo*, ICSID Case No. ARB/77/2, Award (8 August 1980)
[109] *Atlantic Triton Company Limited v. People's Revolutionary Republic of Guinea*, ICSID Case No. ARB/84/1, Award (21 April 1986)
[110] *Benvenuti v. Congo* (n 108) para 349

determined on an equitable basis. In *Atlantic Triton v. Guinea,* there was a prior consensus among the parties that the "disagreement shall be settled *ex aequo et bono* in accordance with the provisions of Article 42(3) of the [ICSID] Convention"[111]. Consequently, the arbitral tribunal decided damages on the basis of equity, awarding a lump-sum payment that was less than one-third of what would have been due to the Claimant. The Claimant's failure to exercise due diligence in performing its functions was cited as a factor behind its decision[112].

The significance of these cases from the perspective of damages is considerable, given the discretion that the *ex aequo et bono* principle granted to the disputing parties. Its implications will be discussed and contrasted with the principles of assessment of damages in a greater extent in the next chapter.

B. Taking of evidence

The procedural rules on the taking of evidence are a crucial resource for the understanding of the exercise of arbitral powers, particularly on the issue of remedies. Like all legal claims, the right to compensation and damages must be proved in investment disputes, as evidence of injury is crucial to the award of requested relief. At the fundamental level, the arbitral tribunal's findings of fact and determination of law is based on the overall record assembled in co-operation with the disputing parties[113]. It is the factual matrix created by the record that forms the basis of the award. Any failure on the part of the tribunal in terms of decision-making beyond the factual record or a lack of appreciation of the record in full opens up the grounds for annulment of the award. Similarly, travelling beyond the terms of reference created by the parties' submissions may also invite the threat of annulment. As noted by the ICSID annulment committee in *Caratube v. Kazakhstan,* tribunals generally do not violate the parties' right to be heard in situations where they ground their decision on legal reasoning not specifically advanced by the parties. However, this is subject to the condition that the tribunal's arguments can be fitted within the legal framework argued during the arbitral proceedings and concern aspects on which the parties could 'reasonably be expected to comment' if they wanted to be taken into account by the tribunal[114].

[111] *Atlantic Triton v. Guinea* (n 109) para 1
[112] Ibid para 31
[113] Sourgens et al. (n 5) 13
[114] *Caratube International Oil Co LLP v. Republic of Kazakhstan*, ICSID Case No. ARB/08/12. Decision on Annulment (21 February 2014) para 94

The scheme for the taking of evidence is incorporated principally under Rules 33 and 34 of the ICSID Arbitration Rules[115] and Article 27 of the UNCITRAL Arbitration Rules 2010. The overall record that is assembled in a case is a product of collaboration and co-operation among the parties and the arbitral tribunal. The role of parties differ significantly from the arbitral tribunal in this regard[116]. Firstly, parties define the factual and legal scope of the dispute through their submissions made to the arbitral tribunal. The tribunal's task here is to resolve the dispute that is defined by the parties and clarify the terms of reference according to which it will carry out its functions. In this manner, the tribunal defines and delimits the boundaries of its own competence over the dispute in question.

Secondly, parties must develop the factual material, legal arguments in their submissions along with the evidence that must support their contentions. Disputing parties are also required to disclose evidence in their possession to each other subject to the request by the opposite party and subject to the tribunal's decisions, where applicable[117]. Further, parties also comment on their own and the other's evidence, thereby assisting the tribunal in its fact-finding process. The tribunal's role is that of a gate-keeper or guardian of the record, and it is up to the tribunal to determine the admissibility, relevance, materiality and weight of the evidence submitted to the record[118]. Tribunals are also empowered to order additional documents, experts or witnesses in order to complete the record and enable them to their tasks set out in the terms of reference[119].

Therefore, arbitral tribunals enjoy considerable discretion to conduct the production and evaluate (including admissibility and relevance) of the evidence placed before them and to make decisions on the claims of parties on this basis[120]. The task of proving any evidence submitted is on the party making such a submission. The burden of proof rule is not provided in all arbitration rules, though there is a near unanimity among tribunals on the application of the basic rule – *actori incumbit onus probundi*. The rule implies that the party which makes an assertion must prove it. In the UNCITRAL Arbitration Rules, this is incorporated under Article 27(1) as "each party shall have the burden of proving the facts relied on to support its claim or defence".

[115] Rules of Procedure for Arbitration Proceedings (the Arbitration Rules) of ICSID were adopted by the Administrative Council of the Centre pursuant to Article 6(1)(c) of the ICSID Convention
[116] Sourgens et al. (n 5) 14
[117] Rule 34 ICSID Arbitration Rules
[118] Article 27(4) UNCITRAL Arbitration Rules; Rule 34(1) ICSID Arbitration Rules
[119] Rule 34(2) ICSID Arbitration Rules
[120] Schreuer (n 93) 643.

Notwithstanding the broad discretion of arbitral tribunals on the issues of evidence, it must be considered that such discretion is not without limit and arbitrators must approach the representation of parties based on good faith and fairness. The tribunal in *Aguas del Tunari* v. *Bolivia* made some relevant observations with respect to the concept of 'necessity' as incorporated in Article 43 of the ICSID Convention[121]. In the tribunal's view, arbitrators must give effect to the necessity requirement when considering requests by parties for production of documents or other evidence. In evaluating such a request for production of evidence, arbitral tribunals must consider: (1) the necessity of the requests made with regard to the specific point the party wants to make, (2) its relevance and likely merits, (3) the cost and burden of the request on the claimant (4) how the request may be specified so as to fulfil the legitimate requests by a party while not allowing inquiries that are an abuse of process[122]. This opinion was also echoed by the arbitral tribunal in *Tokios Tokelés v. Ukraine* that the Tribunal may call upon the parties to produce documents if the Tribunal deems it necessary to do so[123].

Arbitral tribunals have frequently referred to the IBA Rules on the Taking of Evidence in International Arbitration as a resource for guidance in terms of taking requests for evidence and other evidentiary issues in investor-State arbitration[124]. Most recently revised in 2010, these Rules were initially incorporated by the IBA in 1983 seeking to fill the gaps in rules on the taking of evidence in international arbitrations. The IBA Rules provide additional guidance to arbitrators regarding the taking of evidence in comparison to the arbitration rules within the ICSID or UNCITRAL systems, somewhat reducing the need for tribunals to rely solely on their own discretionary powers. This is useful given the tendency of parties to challenge, though rather unsuccessfully, the exercise of discretion regarding the taking of evidence by parties in ICSID annulment proceedings[125]. For instance, in the ICSID annulment proceedings related to *MTD v. Chile*, the Respondent-host State contended that the arbitral tribunal had failed to consider much of the material evidence that had been submitted by the disputing parties, including expert evidence[126]. The annulment committee rejected the Respondent's contention

[121] Article 43, ICSID Convention
[122] *Aguas del Tunari* v. *Republic of Bolivia*, ICSID Case No. ARB/02/3, Procedural Order No. 1.(8 April 2003) para 14
[123] *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Procedural Order No. 3, (18 January 2005) para 25
[124] International Bar Association, IBA Rules on the Taking of Evidence in International Arbitration, Adopted by a resolution of the IBA Council (29 May 2010)
[125] Schreuer (n 93) 645
[126] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment (21 March 2007) paras 56-57.

by holding that the arbitral tribunal had provided sufficient reasoning for its decisions, including the consideration of expert evidence.

The issue of evidence has multiple, cross-cutting implications on the understanding of both discretionary powers and the assessment of compensation and damages. The evidentiary rules within the ICSID and UNCITRAL systems present a crucial focal point over how the procedural freedom that is provided to arbitrators affects the evaluation of damages claims and the evidence supporting them. These will be examined in greater detail going forward.

3.2.3 Lex Arbitri

Having considered the roles of the arbitration agreement and procedural rules in defining the scope of arbitral powers, it is time to turn to the third crucial determinant– *lex arbitri*, or the law of arbitration. *Lex arbitri* incorporates the overarching law of arbitration that is applicable in the 'seat' of an arbitration - the State where the arbitration has its legal domicile. According to Born, *lex arbitri* refers to the law governing all aspects of the conduct of the arbitral proceedings, which includes the internal procedures of the arbitration as well as the external relationship between the arbitration and the courts and law of the arbitral seat[127]. These internal procedures and external relationships are understood as follows:

1. The "internal" procedural issues - This includes matters that lie at the heart of the arbitration process, such as the procedural steps and timetables, rules on evidence and pleadings, conduct of hearings, the arbitrator's procedural discretion, rules on examination of witnesses, provisions for appointment and dismissal of arbitrators, disclosures and discovery powers of arbitrators etc. National laws vary with respect to the extent to which internal procedural rules are laid down by statute or rules. In some countries, these will be regulated largely by the arbitration agreement and the discretion of parties, with only certain mandatory provisions governed by law. In other countries, local laws can be significantly detailed and govern most of the internal procedural issues directly.
2. The "external" relationship between international arbitration proceedings and national courts – The *lex arbitri* will similarly govern the relationship of the arbitration proceeding with the national courts at the seat of arbitration. This would include issues such as the *kompetenz-kompetenz* of the arbitral tribunal, judicial assistance in relation to the

[127] Gary Born, *International Commercial Arbitration* (Kluwer Law International 2009) 1598

> constitution of the arbitral tribunal, judicial assistance in terms of issuing provisional measures in aid of arbitration, judicial review of procedural rulings, the enforcement and setting aside of awards, etc. In effect, the various judicial measures or remedies that can be requested in the arbitration process are covered under the external relationship.

In addition to these, Henderson suggests the inclusion of another aspect of the external relationship as:

> The broader external relationship between arbitrations and the public policies of that place, which includes matters such as arbitrability in addition to the impact of arbitration to the social, religious and other fundamental values of the place[128].

The role of *lex arbitri* is crucial for the determination of the internal procedures of arbitration and in determining its external relationship with the domestic courts where the arbitration is seated. However, there are some methodological challenges that are faced when considering the application of *lex arbitri* of a seat in relation to investor-State arbitrations, given the distinct legal framework within which it operates. Consequently, the implications of *lex arbitri* on the powers of arbitral tribunals are briefly considered in the following sections.

A. Effects of *lex arbitri* on internal procedural issues

Investor-State arbitration, being a unique species of international arbitration, diverges significantly in terms of the application of *lex arbitri* to traditional forms of arbitration. Unlike commercial arbitration, investor-State arbitrations apply the principles of international law, and the principal legal instruments like treaties contain substantial rules with respect to the powers and functions of arbitrators. As already noted in previous sections, investment treaties and the choice of rules of arbitration contained within them contemplate the express powers of arbitral tribunals in conducting proceedings and making decisions on the merits of the dispute. In context of *lex arbitri*, the special provisions contained in the investment agreements and selected arbitration rules would supplant the law of the seat of arbitration, other than those provisions that are mandatorily applicable – a fundamental feature of party autonomy[129]. While State parties to investment agreements can agree to incorporate the domestic law of arbitration

[128] Alastair Henderson, 'Lex Arbitri, Procedural Law and the Seat of Arbitration' (2014) 26 Singapore Academy of Law Journal 887-888

[129] Karl-Heinz Böckstiegel, 'The Role of Party Autonomy in International Arbitration' in International Centre for Dispute Resolution(ed.), *ICDR Handbook on International Arbitration and ADR* (JurisNet 3rd ed. 2017)

of a certain State or territory, treaty practice over the years has largely been in favour of incorporating international procedural rules for the disputing parties to choose from. In the contemporary context, the significance of the choice of the arbitral seat and the procedural law of the arbitration for the internal procedures of the arbitration has materially diminished. The arbitration legislation adopted by most developed states has progressively dispensed with obligations that international arbitrators follow local procedural codes and instead grant parties and tribunals substantial freedom to conduct arbitral proceedings in the manner they deem best[130].

While the internal procedural issues may largely be regulated by the investment agreement and procedural rules of arbitration, the same does not equally hold for the external relationship between international arbitration proceedings and national courts. This is also an issue where some of the major differences between ICSID and non-ICSID arbitration becomes apparent. Some of the pertinent issues in this regard are discussed in the next section.

B. *Lex arbitri* and the relationship between international arbitration proceedings and national courts

While internal procedural rules are largely shaped by the consent of parties in terms of the arbitral agreement, the effect of *lex arbitri* on the arbitration-court relationship is less clear. Scholars have presented varying opinions and theories on the nature of international arbitral proceedings, and to what extent it is tied to national legal systems[131]. While traditionalists have stressed on the national laws of the seat of arbitration as the anchor to all arbitration proceedings, the supporters of the transnational model argue in favour of seeing arbitration as a transnational legal order, though formed within a national legal system, at the same time transcends any individual legal order[132]. The changing relationship between national courts and international arbitration proceedings is a testament to this struggle between ideas. It is also clear from the operation of different arbitral systems that some tend to more closely rely on the domestic legal order than others. It is important to distinguish ICSID arbitration from other non-ICSID arbitrations in this regard.

[130] Born (n 127) 1593-1595
[131] Paulsson (n 15) 20
[132] Emmanuel Gaillard, 'Transcending National Legal Orders for International Arbitration' in Albert Jan Van Den Berg (ed.), *International Arbitration: The Coming of a New Age?* (Wolters Kluwer 2012)

The ICSID system seeks to provide a self-contained system of arbitration that is de-localised from any national legal system[133]. The choice of seat of arbitration has limited effect on ICSID arbitrations in terms of both internal and external considerations of *lex arbitri*, as opting-into ICSID arbitration leads to the exclusion of all other remedies, including domestic courts. Article 26 of the ICSID Convention provides that consent to arbitration shall be deemed to exclude any other remedy unless specifically stated by the parties to the arbitration agreement. Consent to ICSID Arbitration by the disputing parties necessary implies the exhaustion of the rights of parties to seek relief in other national or international forum unless the parties choose to deviate from the provision by mutual agreement. The second implication of consenting to ICSID arbitration is that of non-interference by domestic courts once the arbitration has been instituted. This means that ICSID arbitrations operate independently from the supervision of domestic courts, regardless of whether they are at the seat of arbitration. The deliberate design of the Convention in these terms was aimed at overcoming the problems associated with foreign legal proceedings. The general reasoning for the exclusive remedy rule and non-interference principle is to provide an effective forum to the parties and to dispense with proceedings which parties generally do not consider to be viable. According to Schreuer's commentary to the ICSID Convention:

> Investors often do not perceive litigation in the courts of host States as a reliable way of protecting their interests. In turn, host States dislike getting involved in litigation abroad. This applies not only to proceedings on the merits but also to those ancillary to arbitration. In addition, State immunity tends to have a distorting effect on litigation between States and non-State parties before domestic courts. The principle of autonomy for ICSID arbitration, as expressed in Art. 26, therefore, meets a number of needs of the host States and of the foreign investors[134].

Additionally, the ICSID system has an enforcement mechanism that is independent of domestic legal orders. ICSID awards become automatically enforceable and do not require the intervention of domestic courts. Article 53(1) of the Convention mandates all awards to be binding on the parties and not subject to appeal or other remedy other than those provided in the ICSID Convention. This may be contrasted against the non-ICSID systems, such as the UNCITRAL Arbitration Rules. Unlike ICSID awards, UNCITRAL arbitrations have a distinct relationship with the seat of arbitration, defined as 'place of arbitration' under Article 18 of the UNCITRAL Rules as follows:

[133] Sabahi et al. (n 28) 84
[134] Schreuer et al. (n 93) 352

> If the parties have not previously agreed on the place of arbitration, the place of arbitration shall be determined by the arbitral tribunal having regard to the circumstances of the case. The award shall be deemed to have been made at the place of arbitration.

The UNCITRAL Rules authorise the tribunal to elect the place of arbitration in the absence of prior agreement between the parties. In certain institutions, such as the Permanent Court of Arbitration, it is common for the place of arbitration to be designated to be the Hague. The necessary implication of this is that the *lex arbitri*, being the law of arbitration of the Netherlands, becomes applicable in such a case. The intervention of national courts at the seat of arbitration can be effectuated in various ways. Under the 2010 UNCITRAL Rules, the choice of seat and the consequent mandatory norms of the place of arbitration can affect the arbitration process. Some are stated as follows:

1. Restrictions of arbitrability - Certain legal issues may not be arbitrable in the seat of arbitration, such as disputes regarding competition law, insolvency and bankruptcy, corruption, etc. Even though a tribunal may be properly formed for a dispute, non-arbitrability may prove to be pathological to the arbitral process. Arbitral awards passed on such issues will not be enforceable at the place of arbitration.
2. Restrictions on disputing parties and arbitrators – Mandatory norms may prevent certain state entities from arbitration if they are found to be lacking capacity to arbitrate under domestic law. Similarly, persons may be restricted from acting as arbitrators due requirements of competence, capacity, nationality etc.
3. Extent of interference – Some states are more stringent in their application of mandatory norms compared to others, including judicial interference into the arbitration. The degree of stringency along with the effects of non-compliance with the mandatory norms would have differing effects on the proceedings.
4. Prohibition against certain measures or awards – Certain limited measures or types of awards may be prohibited under the mandatory norms. This includes acceptability of written affidavits, allowability of decisions passed *ex aequo et bono*, circumscribing of the arbitral tribunal's powers to decide on its own jurisdiction (kompetenz-kompetenz) by a local court's powers etc.

The illustrative list of possible mandatory norms also indicates the different ways in which an arbitral tribunal's authority can be regulated or even ousted at the arbitral seat. While ICSID arbitrations are largely immune to such actions, the interactions between ICSID tribunals and national courts are by not fully closed. In fact, the ICSID Additional Facility Rules permit parties to approach national judicial authorities to obtain interim measure under Rule 46(4) of

the Additional Facility Rules. The possibility to approach courts under Rule 46(4) must be understood in the context of the ICSID Additional Facility Rules, under which the provisions of the ICSID Convention are inapplicable to a dispute. Consequently, ICSID tribunals under the Additional Facility Rules are neither empowered to provide exclusive remedies under Article 26, nor are awards passed under these rules directly enforceable under Article 53. However, even under the ICSID Arbitration Rules, parties are able to obtain provisional measures from domestic courts in relation to ICSID arbitrations. The relevant provision here is Rule 39(6), which provides that:

> Nothing in this Rule shall prevent the parties, provided that they have so stipulated in the agreement recording their consent, from requesting any judicial or other authority to order provisional measures, prior to or after the institution of the proceeding, for the preservation of their respective rights and interests.

Rule 39(6) places an important prerequisite where a prior agreement (either directly made with the other party or incorporated in the treaty consenting to arbitration) is necessary for approaching a judicial authority. Subject to this requirement, which also modifies the consent under Article 26, the parties have an alternative to the arbitral tribunal for receiving interim measures of protection. Interim measures may also be sought from a judicial authority in addition to measures granted by the arbitral tribunal under Article 26(9) of the UNCITRAL Arbitration Rules, without the requirement of any prior agreement between the parties.

4. The Distinct Scope of Discretionary Powers

So far in this chapter, we have examined the foundational concepts of arbitral authority and power that form the basis on which arbitral tribunals carry out their function of settling investment disputes. The sources of arbitral powers have been considered broadly, without a clear distinction made for powers that can be specifically considered to be ‘discretionary’. This is an important task given that our primary concerns are chiefly with respect to the exercise of arbitral discretion, even though it may not always be possible to separate discretionary and non-discretionary powers. The rest of this chapter will explore the idea of discretionary powers of arbitrators and their distinct application in arbitral decision-making. This understanding will be applied in examining their role in the various stages of determination of compensation and damages in the next chapter.

4.1 The content of discretionary powers

The concept of discretionary powers of arbitrators, also understood as discretionary authority or arbitral discretion, is not defined in the sources of arbitration law, including the arbitration agreement, rules of procedure or domestic laws. Investment agreements or arbitration rules may leave certain issues to be governed by the "arbitral tribunal's discretion", but do not delve into the meaning of such discretion. For instance, Article 17(1) of the UNCITRAL Arbitration Rules refer to the arbitral tribunal's discretion to conduct proceedings but do not define discretion in any manner. Similar provisions referring to discretion are also found in various institutional rules, such as the 2017 ICC Rules of Arbitration[135], 2014 LCIA Arbitration Rules[136] and the SIAC Arbitration Rules[137]. Instead of constructing meanings out of the plain texts of such instruments, greater clarity regarding the scope of discretionary powers may be found in arbitral awards, scholarly writings and commentaries that have engaged with the powers of arbitrators more substantively.

Legal scholarship on the subject of arbitral discretion has largely avoided giving a well-defined or narrow meaning to arbitral discretion. Scholars and commentators refer to arbitral discretion in general terms, such as the "power of arbitrators to make decisions on the basis of their discretion"[138] or as an analogue to the concept of judicial discretion[139]. Instead of a distinct juridical concept, the reference to arbitral discretion in scholarship indicates towards the general notion of arbitrators having the legal authority, or arbitral power, to make decisions as per their best judgement. This point might be better illustrated by referring to the opinions of some scholars regarding the scope of discretion on matters that govern procedural as well as substantive issues (or merits).

4.1.1 Procedural discretion

In an influential essay on procedural discretion in arbitration, noted arbitrator W.W. Park observed:

[135] Article 3(4), Appendix VI of the 2017 ICC Rules of Arbitration
[136] Article 14.5, 2014 LCIA Arbitration Rules
[137] Rule 19.4, 2016 SIAC Rules
[138] Hattie Middleditch, 'The Use of Inherent Powers by Arbitrators to Protect the Public at Large', in Franco Ferreri and Friedrich Rosenfeld (eds.), *Inherent Powers of Arbitrators* (JurisNet 2018)
[139] Bjorklund and Brosseau (n 58) 41

> …arbitration is constantly reinventing itself to adapt to each particular case and legal culture, while retaining a vital core which aims at final and impartial resolution of controversies outside national judicial systems. One reaction to arbitration's protean nature has been an emphasis on broad grants of procedural discretion to the arbitrators. Arbitrators can conduct proceedings in almost any manner they deem best, as long as they respect the arbitral mission and accord the type of fundamental fairness usually called 'due process' in the United States and 'natural justice' in Britain, which includes both freedom from bias and allowing each side an equal right to be heard.[140]

Park sees the idea of procedural discretion as rooted in the very nature of the international arbitration process that is shaped by an amalgamation of different legal cultures and values. He considers the choice of arbitrating by parties as a conscious decision to avoid the complexities that often mire national courts. While noting the perceived advantages of the procedural autonomy of the arbitration process, Park observed how the absence of precise procedural rule allowed arbitrators to create appropriate norms that were specifically suited to each particular case. This procedural flexibility would allow for a dispensation of justice unhindered by tedious procedural requirements that is seen with court proceedings. This discretion given to the arbitrators allows them to customise proceedings for the benefit of the disputing parties. As Park puts it:

> Like a bespoke tailor, the creative arbitrator cuts the procedural cloth to fit the particularities of each contest, rather than forcing all cases into the type of ill-fitting off-the-rack litigation garment found in national courts[141].

Park's characterisation of arbitral discretion lies in the context of the debate between the procedural flexibility available in the exercise of discretion as opposed to the greater predictability provided by written rules. He is sceptical of the wide margin of discretion that is given to arbitrators on procedural issues and opines that such procedural flexibility may not be as much of an "unalloyed good" as claimed by proponents of the system[142].

A similar conception of arbitral discretion is drawn by Hayward in his study on the role of procedural arbitral discretion in resolving conflict of laws issues[143]. Hayward critiques the prevailing tendency in international commercial arbitration of resorting to arbitral discretion

[140] W.W. Park, 'Arbitration's Protean Nature: The Value of Rules and the Risks of Discretion' (2003) 19 *Arbitration International* 3, 273
[141] Ibid 281
[142] Ibid 293
[143] Benjamin Hayward, *Conflict of Laws and Arbitral Discretion - The Closest Connection Test* (Oxford University Press 2017)

over rules as a means of determining the substantive law governing the merits of the dispute, where the choice of law is not clear from the agreement of parties[144]. His criticism is based on the contention that such discretion is often too wide and creates a retroactive determination of the applicable law over a dispute. Instead, he recommends resorting to a bright-line test for resolving conflict of laws issues. Hayward's conceptualisation of arbitral discretion is similar to Park, where it is seen as a broad power of arbitrators to conduct proceedings in a manner of their choosing. However, such discretion is limited by the terms of the arbitration agreement of the parties, any applicable rules of procedure, and subject to due process requirements.

The same proposition is also placed by Berger with regard to the role of arbitral discretion in the consideration of evidentiary privileges[145]. Noting the 'broad discretion' accorded to tribunals by arbitration rules on the taking of evidence, Berger contends that the relative silence in the rules regarding evidentiary privileges results in a presumption in favour of discretionary decision-making by tribunals. The flexibility of the arbitral process acts as a method to mitigate the differences of the domestic systems from which the parties come. However, leaving such issues to arbitral decision-making during the proceedings may lead to the "dark side of (arbitral) discretion" which may lead to discomfort for disputing parties when arbitrators make up their own rules as they go along, divorced from any precise procedural rules or framework that may be more straightforward and predictable[146].

Berger conceives arbitral discretion along the same line as Park and Hayward in considering the inherent tensions between procedural flexibility and fairness to the parties. The idea of 'wide discretion' applies in a similar manner to the taking of evidence in arbitral proceedings, as it does with procedural conduct or resolving conflict of law issues. On issues of evidence, such discretion is arguably wider considering that arbitral tribunals are not constrained by evidentiary rules brought under the choice of applicable law in a dispute[147]. While tribunals must respect the fundamental legal principles of consent, procedural fairness and equality of treatment, they are largely permitted to make decisions on the admissibility, relevance, materiality and weight of evidence on their own accord.

Park and others consider procedural flexibility in arbitration as the primary rationale for allocating procedural discretion to arbitral tribunals. Procedural flexibility is a feature that is as

[144] Ibid 1.03
[145] Klaus Peter Berger, 'Evidentiary Privileges: Best Practice Standards versus/and Arbitral Discretion' (2006) 22 *Arbitration International* 4, 501
[146] Ibid 513
[147] Ibid 516

foundational to arbitration as party autonomy[148]. In permitting an arbitral tribunal to conduct proceedings "in such manner as it considers appropriate", the arbitration rules present a conscious decision of the drafters to avoid complex procedural requirements in favour of a flexible framework that aids the dispute settlement process[149]. Procedural discretion can therefore be considered as a facilitative tool enabling arbitral tribunals to making independent decisions on the conduct of proceedings. In the specific framework of investor-State arbitration, some of the arbitration rules conferring such power to the arbitral tribunal include Article 44 of the ICSID Convention (read with Section 3 of the ICSID Arbitration Rules) and Article 17 of the UNCITRAL Arbitration Rules. While both systems structure their provisions differently, they confer a similar degree of procedural discretion to tribunals along with applicable constraints.

Under the ICSID system, the procedural discretion of arbitrators exists as a residual power that is used to fill gaps or address the *lacunae* within existing procedural rules[150]. Article 44 of the ICSID Convention provides that:

> Any arbitration proceeding shall be conducted in accordance with the provisions of this Section and, except as the parties otherwise agree, in accordance with the Arbitration Rules in effect on the date on which the parties consented to arbitration. If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.

The second part of the article makes clear that the tribunal's discretion is engaged only when the Articles of the Convention and the Arbitration Rules are unable to sufficiently address a procedural question. Even while addressing such a question, the tribunal must not go beyond the framework provided by the Convention, Arbitration Rules and the parties' agreement on procedure[151]. In effect, the procedural discretion of the tribunal lies at the lowest rung within the hierarchy of procedural rules applicable to ICSID-administered arbitrations. Procedural discretion under Article 44 has been invoked for a variety of decisions, including the resumption

[148] J Farris, 'The Procedural Flexibility of Arbitration as an Adjudicative Alternative Dispute Resolution Process', (2008) 41 De Jure 504
[149] Caplan and Cohen (n 11) 286
[150] Schreuer (n 93) 688
[151] Ibid 689

and stay on proceedings[152], setting procedural dates and time limits[153], or the acceptance of *amicus curiae* briefs[154].

Under Article 17(1) of the UNCITRAL Arbitration Rules 2010, a similar framework for the exercise of procedural discretion is provided. As we have already noted earlier in this chapter, arbitrator discretion to conduct proceedings is circumscribed by certain rules that are mandatory in nature[155]. In a manner similar to the ICSID Convention, procedural discretion under the UNCITRAL Arbitration Rules is constrained by mandatory provisions on procedure and any modification to the Rules as may be agreed to by the parties. For example, the Iran-United States Claims Tribunal (IUSCT) adopted a procedural system that was based on article-by-article based modifications of the UNCITRAL Arbitration Rules 1976[156]. Such modifications may thus constrain a tribunal's ability to shape proceedings.

This provision was introduced as part of the amendment process of the 1976 version of the Arbitration Rules before the UNCITRAL Working Group on Arbitration and Conciliation[157]. The inclusion of such a directive in the exercise of discretion was purportedly inspired by similar amendments made to the arbitration rules of other institutions, such as by the London Court of International Arbitration and the American Arbitration Association[158]. Some concerns were raised during the deliberations about the necessity of such a provision and the risk of challenges being raised by parties for failure in avoiding unnecessary delay or expenses[159]. However, on the balance it was considered that such a provision would add leverage the tribunal's discretion in conducting proceedings when necessary, and the amended Article 17(1) was eventually incorporated[160].

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[152] *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6 Decision of the Tribunal on the Objections to Jurisdiction (29 January 2004); *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Decision on Preliminary Objections to Jurisdiction (29 August 1984)

[153] *Biwater Gauff* v. *Tanzania*, ICSID Case No. ARB/05/22, Procedural Orders Nos. 1–3 and 5–6, 31 March, 24 May, 29 September 2006, 2 February and 25 April 2007; *Suez et al.* v. *Argentina*, ARB/03/19, Procedural Order No. 1, 14 April 2006; *Pey Casado* v. *Chile*, ICSID Case No. ARB/98/2, Procedural Order No. 13, 24 October 2006, Procedural Order No. 14, 22 November 2006.

[154] *Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic, ICSID Case No. ARB/03/19,* Order in Response to Transparency and *Amicus Curiae* Petition (19 May 2005)

[155] See section 2

[156] Tribunal Rules of Procedure, Iran-United States Claims Tribunal (3 May 1983)

[157] UNCITRAL, 'Report of the Working Group on Arbitration and Conciliation on the Work of its Forty-Fifth Session' (2006) U.N. Doc A/CN.9/614

[158] UNCITRAL, 'Settlement of Commercial Disputes: Revision of the UNCITRAL Arbitration Rules Note by the Secretariat,' (2006) U.N. Doc A/CN.9/WG.II/WP.143

[159] UNCITRAL (n 157) para 76

[160] UNCITRAL, 'Report of the Working Group on Arbitration and Conciliation on the Work of its Forty-Sixth Session' (2007) U.N. Doc A/CN.9/619 para 114

Another distinction that must be noted with respect to non-ICSID arbitrations in general is the effect of the mandatory provisions contained in the *lex arbitri* at the seat of the arbitration. Neither by procedural discretion of tribunals nor by agreement between parties can proceedings be conducted if such proceedings are in violation of the mandatory provisions. Additionally, these provisions may not be derogated from or modified either by the tribunal acting on its own or by party agreement[161]. Therefore, mandatory provisions of domestic law can act as constrains to procedural discretion. A failure to abide by the mandatory provisions may result in the setting aside of the arbitral award at its seat, thereby making it imperative for parties and the arbitral tribunal to ensure compliance with such provisions as applicable. In ICSID proceedings, the concerns regarding mandatory provisions under the *lex arbitri* are replaced by the mandatory provisions as laid down by the ICSID Convention, derogation from which may draw annulment of the arbitral award under Article 52(1)(d) of the Convention[162]. This and other consequences of breach of arbitration rules in the exercise of discretion will be explored further in the succeeding chapters.

The discussions so far have reflected an understanding of procedural discretion as a broad decision-making power in relation to various procedural issues in arbitration. The scope of such discretion, where arbitrators may decide the course of action or make a decision on their own accord, is limited by the very rules that grant such discretion. The principles of natural justice and due process provide the bounds within which arbitral tribunals are free to make procedural decisions as suited to the dispute at hand. As aptly stated in *Redfern and Hunter on International Arbitration:*

> An international arbitration may be conducted in many different ways; there are few fixed rules. Institutional and ad hoc rules of arbitration often provide an outline of the various steps to be taken, but detailed regulation of the procedure to be followed is established either by agreement of the parties, or by directions from the arbitral tribunal, or a combination of the two. The flexibility that this confers on the arbitral process is one of the reasons why parties choose international arbitration over other forms of dispute resolution in international trade[163].

Having developed a general understanding of procedural arbitral discretion, it would be useful to see how discretion is exercised in addressing substantive questions in disputes.

[161] Caplan and Cohen (n 11) 289
[162] Schreuer (n 93) 679
[163] Nigel Blackaby and Constantine Partasides, *Redfern and Hunter on International Arbitration (Student Edition)*, (Oxford University Press 6th ed. 2015) 353

4.1.2 Substantive Discretion

Beyond issues of procedure, arbitral tribunals often resort to the exercise their discretionary powers in making decisions on issues that can be termed as the merits or the substantive questions of a dispute. This 'substantive' discretion of arbitral tribunals is not only a crucial element to the decision-making process but also a necessary tool for arriving towards definitive outcomes, as we will see going forward. Like its procedural counterpart, substantive arbitral discretion is not defined in any international treaties or legal instruments, including rules of procedure. In fact, the substantive and procedural aspects of discretion are not often distinguished from each other but treated as a singular concept of discretion carrying these dual characteristics. While most discussions on arbitral discretion have centred around procedural issues, some scholars have also recognised the application of discretion regarding non-procedural questions. Discretionary inherent powers regulate not only procedure but also play a role in the determination of merits or substantive issues. The discretion extends over a host of issues like the interpretation of the scope of treaty standards and exceptions such as 'necessity'[164], determination of the standard of proof in adducing evidence[165], the assessment of damages[166], allocation of costs of arbitral proceedings[167], and decisions on allegations of corruption and other wrongdoings[168], among others.

In certain instances, substantive discretion may be deeply intertwined with procedural decision-making, such as at the stage of gathering and evaluation of evidence. While decisions on admissibility of certain evidence can be considered to be an exercise of procedural discretion, the appreciation of the weight, relevance and standard of proof would correspond to substantive discretion. Arbitration rules on evidence envisage both of these aspects in granting powers to the arbitral tribunal. For example, Rule 34(1) of the ICSID Arbitration Rules is stated as:

> The Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value.

[164] Sureda (n 4) 40
[165] Sourgens et al. (n 5) 76
[166] Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (BIICL 2008) 124. See also, Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (Wolters Kluwer 2008)
[167] Susan D. Franck, 'Rationalizing Costs in Investment Treaty Arbitration' (2011) 88 Washington University Law Review 769
[168] Sophie Nappert, 'International Arbitration as a Tool of Global Governance: The Use (and Abuse) of Discretion' in Eric Brousseau, Jean-Michel Glachant, and Jérôme Sgard, *The Oxford Handbook of Institutions of International Economic Governance and Market Regulation* (Oxford University Press 2019)

These distinct functions of judging admissibility and probative value of evidence correspond to the dual aspects of discretion. In examining the 'probative value' of evidence, arbitral tribunals are given full authority to decide whether such evidence fulfils the applicable standard of proof without having to refer to any national or international rules of evidence[169]. Tribunals are not bound by the parties' evaluation of the evidence presented by each other and are free to make their choice on the basis of their discretion[170]. Therefore, the exercise of discretion implies the personal satisfaction of the arbitrators regarding the probative value of the evidence instead of the fulfilment of a legal standard.

Another perspective to the scope of substantive arbitral discretion is presented by Nappert, who frames discretion within the wider governance function of international arbitration[171]. It is observed that the exercise of substantive discretion by international arbitrators arises out of a need for gap-filling in international law and in resolving issues where no legal precedents are available. In considering the two separate issues of corruption and damages assessment in investor-State arbitration, arbitral tribunals resort to discretion in the absence of applicable legal provisions, rules or precedent on such issues. Beyond the primary function of resolving the dispute at hand, the consequences of such discretionary decision-making also be tied to the governance function of international arbitration, particularly in the context of foreign investment protection. While the scope and legitimacy of this secondary governance function has been challenged by scholars on various grounds[172], it is the criticism of the manner of exercise of substantive discretion that is relevant in the present discussion. On this aspect, the manner of exercise of substantive discretion and its reasoning exists as an unresolved problem in investor-state arbitration[173].

Most of the detailed positions on substantive arbitral discretion have developed in the context of compensation and damages in investor-State arbitration. As attested by numerous arbitral tribunals over the decades, the valuation of compensation and damages is filled uncertainties and it is not always possible to precisely ascertain the amount of losses suffered by the party

[169] Schreuer (n 93) 667
[170] *Middle East Cement Shipping and Handling Co. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, (12 April 2002) paras. 74–75, 92–94.
[171] Nappert (n 168) 3
[172] Alec Stone Sweet and Florian Grisel, *The Evolution of International Arbitration: Judicialization, Governance, Legitimacy* (OUP 2017) 219; Joshua Karton, 'International Arbitration Culture and Global Governance', in Walter Mattli and Thomas Dietz, *International Arbitration and Global Governance: Contending Theories and Evidence* (OUP 2014)
[173] Nappert (n 168) 21

claiming damages[174]. However, such uncertainties cannot be the ground for rejecting the claim for damages completely and arbitral tribunals must reach a satisfactory approximation on the basis of the facts and evidence available. These two positions were summarised by the ICSID Tribunal in in *Compañía de Aguas (Vivendi) v. Argentina* with reference to previous awards as:

> …it is well settled that the fact that damages cannot be fixed with certainty is no reason not to award damages when a loss has been incurred. In such cases, approximations are inevitable; the settling of damages is not an exact science.[175] (emphasis added)

It is in the dual processes of ascertainment and approximation of damages where arbitral discretion has an important role to play. The ICSID ad-hoc committee for the annulment of the arbitral award in *Rumeli Telekom v. Kazakhstan* observed that once the finding of loss of real value has been made, the determination of what value that must be ascribed to that loss becomes the subject of the tribunal's own "informed estimation". Therefore, the tribunal in this dispute was not limited in that exercise to the evidence or figures put forward by the Parties.[176] The tribunal went on to add importantly that the estimation of damages is not an "exact science":

> It is of the essence of such an exercise that the tribunal has a measure of discretion since the final figure must of its nature be an approximation of the claimant's loss. There may in that context be real limitations on the extent of reasoning which can reasonably be expected[177].

The use of 'informed estimation' in the determination of damages is nothing but the exercise of substantive discretion by the arbitral tribunal. The annulment committee's justification for the tribunal's decision-making in the case was in respect to the choice of valuation methodology that was adopted by the tribunal. The annulment committee was of the opinion that as long as the choice for the valuation approach by the arbitral tribunal was well-reasoned, such choice could not be assailed under the legal grounds for annulment that were relied on by the Applicant. This position has largely been followed in investor-state arbitration, with the norm of permitting wide substantive discretion to arbitral tribunals in making decisions regarding the approximation of damages to be awarded.

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[174] See, e.g., *Compañía de Aguas v. Argentina*, ICSID Case No. ARB/97/3 Final Award (20 August 2007) ; *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Annulment Proceeding, paragraph 351 (Sept. 1, 2009); *ADC Affiliate Ltd. v. Hungary*, ICSID Case No. ARB/03/16, Final Award, paragraph 521 (Sept. 27, 2006); *Himpurna Cal. Energy Ltd. v. PT (Persero) Persusahaan Listruik Negara (Indon.)*, Final Award, paragraph 374 (UNCITRAL May 4, 1999), 25 Y.B. Comm. Arb. 13 (2000); *Sapphire Int'l Petroleum Ltd. v. Nat'l Iranian Oil Co*., Arbitral Award (Mar. 15, 1963), 35 I.L.R. 136, 187–88.

[175] *Aguas v. Argentina*, (n 174) para 8.3.16

[176] *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Decision of the Ad-Hoc Committee (25 March 2010) para 179

[177] Ibid.

Arbitration scholarship has held particular interest in the role of equity in the exercise of discretion by arbitral tribunals on damages. This has been variously described as equity-based discretion[178] or the considerations of equity by arbitral tribunals[179]. The problem of uncertainty and approximation in the assessment of damages is the principal basis for the incorporation of equity into the decision-making process by arbitral tribunals. As observed by Ripinsky and Williams, the reliance of tribunals on equitable considerations in their awards on damages, whether in an explicit or implicit manner, is undisputable. Because of difficulties involved in the precise assessment of damages, some of the subjective elements present in many assessment methodologies and the need for approximations, tribunals are almost inevitably guided by equitable considerations.[180]

It is important to differentiate equitable considerations in damages assessment from decisions made on the basis of equity – *ex aequo et bono*. As noted earlier in this chapter, international arbitration rules allow arbitral tribunals to make decisions *ex aequo et bono*, subject to the prior consent of the disputing parties. While there have been a few cases where arbitral tribunals in investment disputes have proceeded on this basis[181], disputing parties generally mandate decision-making to be made on the basis of the applicable law, not equity. However, resorting to equitable considerations in the assessment of damages does not imply a decision being made *ex aequo et bono*. Instead, equitable considerations are used to overcome the uncertainties involved in the damages assessment process and in reaching a fair estimation of the damages that are to be awarded. Arbitral tribunals have, in the past, made this distinction clear by holding that tribunals have the authority to take equitable considerations into account while determining the amount of damages to be awarded. This was the position taken by the *Kuwait v. Aminoil*, tribunal, which stated that any estimate in monetary terms and intended to express the value of an asset, undertaking, contract, or of services must take equitable principles into account.[182]

[178] Silke Noa Elrifai, 'Equity-Based Discretion and the Anatomy of Damages Assessment in Investment Treaty Law' (2017) 34 Journal of International Arbitration 5, 835–888. See also, Meriam N. Alrashid, 'The Arbitral Tribunal's Discretion in Quantifying Damages' in Ian A. Laird et al. (eds.), Investment Treaty Arbitration and International Law (JurisNet 2015)

[179] JF Merizalde Urdaneta, 'Proportionality, Contributory Negligence and Other Equity Considerations in Investment Arbitration', in Ian A. Laird et al. (eds.), Investment Treaty Arbitration and International Law (JurisNet 2015)

[180] Ripinsky and Williams (n 166) 124

[181] *S.A.R.L. Benvenuti & Bonfant v. Government of the People's Republic of the Congo* ICSID Case No. ARB/77/2*; Atlantic Triton Company Limited v. People's Revolutionary Republic of Guinea* ICSID Case No. ARB/84/1; *Antoine Goetz and Others v. Republic of Burundi* ICSID Case No. ARB/95/3

[182] *The Government of the State of Kuwait v. American Independent Oil Company*, Award (24 March 1982)

In support of this position, the arbitral tribunal referred to some observations made by the International Court of Justice in an Advisory Opinion regarding the judgement of the Administrative Tribunal of the ILO. The Court in this Advisory Opinion had stated that resorting to equitable principles did not mean an intention to depart from principles of law. As the precise determination of the actual amount to be awarded could not be based on any specific rule of law, the tribunal fixed in its discretion what the Court has in older cases described as the true measure of compensation and the reasonable figure[183]. The *Aminoil* tribunal also made a reference to the ICJ's decision in the *North Sea Continental Shelf Cases*, wherein the Court had held that the content of the applicable law may itself require the application of equitable principles[184]. While the content of the applicable law would determine the existence of an 'internal' equity, it is not unforeseeable for arbitral tribunals to identify such equitable principles in the principles on compensation and damages as applicable. The ICSID tribunal in the subsequent case of *Tecmed v. Mexico* affirmed the use of equitable discretion without resorting to decision-making *ex aequo et bono*.[185] The general position on the necessity of equitable considerations in the assessment of damages was perhaps most aptly laid down by the arbitral tribunal in the *Himpurna v. PLN* arbitration, where the tribunal stated that:

> In this case as in so many others, it is impossible to establish damages as a matter of scientific certainty. This does not, however, impede the course of justice…Moreover, considerations of fairness enter the picture, to be assessed, inevitably, by reference to particular circumstances. The fact that the Arbitral Tribunal is influenced in this respect by equitable factors does not mean that it shirks the discipline on the basis of legal obligations[186].

The position taken by these arbitral tribunals indicate towards a clear separation between equitable considerations and decisions based on *ex aequo et bono*. Yet, the applicability of some of these observations to investor-State arbitration may not be as congruent. For instance, Marboe contests the applicability of the observations made in the ICJ's Advisory Opinion in the *Administrative Tribunal of the ILO* case in the context of international investment law. Marboe notes that though the ICJ Advisory Opinion justified the consideration of reasonable estimation in the absence of any specific rule of law, international investment law contains well-

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[183] *Judgement of the Administrative Tribunal of the ILO upon Complaint Made against UNESCO*, Advisory Opinion (23 October 1956) ICJ Reports 1956,100 et seq.

[184] *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark, Federal Republic of Germany v the Netherlands)* Judgement of 20 February 1969, ICJ Reports 1969, 3 para. 85. Referred to in *Kuwait v. Aminoil* para 78.

[185] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2. Award (29 May 2003) para 190

[186] *Himpurna California Energy Ltd. v PT. (Persero) Perusahaan Listruik Negara*, UNCITRAL Ad Hoc-Award of 4 May 1999, YCA XXV (2000), para 267

established and identifiable legal norms on the basis of which assessment of compensation and damages is carried out[187]. Therefore, it would be inappropriate for an investment tribunal to resort to equitable considerations in determining a 'reasonable figure' for compensation. It may, however, be argued that even with the well-defined norms on compensation and damages, investment law can only guide a tribunal so far. When it comes to determining the precise sums of money to be awarded, tribunals must resort to the evidence before them and a certain extent of discretion in identifying the 'right' amount. This fact is also recognised by Marboe, who recognises that some amount of discretion will always be exercised by the arbitral tribunal.

The position taken by the tribunal in *Kuwait v. Aminoil* has been echoed practice of the Iran-US Claims Tribunal (IUSCT), wherein the role of equitable considerations has been well established. The terms 'relevant circumstances' and 'reasonableness' have been frequently used at the IUSCT as a broad concept that envelops considerations of fairness, equity and acknowledges the uncertainties involved in the calculation and approximation of compensation and damages[188]. For example, the tribunal in *Phillips Petroleum v. Iran* noted with respect to the adjustments to the amount of compensation calculated using the Discounted Cash Flow (DCF) method in a separate case of *Starrett Housing v. Iran*[189] observed that need for some adjustments to valuation is permissible, as the determination of value by a tribunal must take into account all relevant circumstances, including equitable considerations.[190] In another case of *American International Group v. Iran,* the tribunal faced a wide range of possible valuation of an insurance company that had been nationalized by the Iranian government, in which the investor had an equity interest. In considering the high and low limits of proposed values of company which are wide apart, the tribunal will have to make an approximation of value, taking into account "all relevant circumstances", clearly demarcating a space for discretion.[191]

The consideration of relevant circumstances were similarly cited for the application of adjustments or approximations of value of different forms of assets in different cases before the IUSCT[192]. As the IUSCT has tremendously influenced the practice of both ICSID and non-

[187] Marboe (n 73) para 3.347
[188] Marboe (n 73) para 3.354
[189] *Starrett Housing Corporation and The Government of the Islamic Republic of Iran*, Interlocutory Award No. ITL 32-24-1 (19 December 1983), reprinted in 4 Iran-U.S. C.T.R. 122
[190] *Phillips Petroleum Company Iran v. The Islamic Republic of Iran*, the National Iranian Oil Company IUSCT Case No. 39, Award No. 425-39-2 (29 June 1989)
[191] *American International Group, Inc. and American Life Insurance Company v. Islamic Republic of Iran and Central Insurance of Iran (Bimeh Markazi Iran)* 4 Iran-US CTR (1983), 109
[192] *Shahin Shaine Ebrahimi v. Iran*, Award (12 October 1994), 30 Iran-US CTR 170; *Eastman Kodak v. Iran*, Award (19 July 1991), 27 Iran-US CTR 3

ICSID arbitral tribunals, it is not wonder that these concepts have also percolated into their practice[193].

The discussion on equitable considerations also clarifies the role of substantive discretion as the facilitative tool enabling arbitrators to engage in such decision-making. Without the necessary discretion, arbitral tribunals would be unable to take equitable considerations into consideration and consequently make adjustments to the quantum of damages, leaving only the option of fully accepting or rejecting the submissions of either of the disputing parties. It must also be clarified that the exercise of discretion does not necessarily imply the application of equitable considerations. Arbitrators may use their discretion in resolving disputes in a number of ways, one of which is the incorporation of equitable considerations, particularly when the quantum of damages are difficult to determine otherwise. Marboe particularly warns about the dangers of arbitral tribunals referring to equity in determining quantum when faced with difficult cases involving complex valuations:

> International courts and tribunals do have discretion, but it should not be used as an excuse for not conducting calculation as precisely as possible. In view of modern valuation tools and techniques, including information on electronic sources, a lot of uncertainty and complexity can be built into generally accepted valuation methods.[194]

While most commentators agree on the necessity of discretion to a certain extent for arbitral tribunals to function effectively, concerns have been raised regarding the manner of exercise of discretion and the limits to which considerations of equity may be stretched[195]. Unlike procedural discretion, there is usually no guidance given in investment treaties or agreements about the kind of decisions that arbitral tribunals can take on the basis of their substantive discretion. While procedural rules also subject any discretionary exercise to the fulfilment of certain mandatory norms, the same does not extend towards substantive discretion.

Within the realm of compensation and damages assessments, treaty rules may specify certain elements, such as the applicable legal principles on compensation or damages (‘full reparation’, ‘fair reparation’, ‘fair and equitable compensation’ etc.) and the basis of compensation (‘fair value’. ‘market value’, etc.). Some treaties may also direct arbitral tribunals to make adjustments to the damages claimed on the basis of contributory fault, negligence, compensation already paid and other mitigating circumstances. Investment treaties rarely

[193] Marboe (n 73) para 3.355
[194] Ibid 3.359
[195] Urdaneta (n 179) 305

incorporate more detailed provisions beyond these considerations. This manner in which compensation and damages provisions are structured combined with the arbitrator's duty to decide on the issues in dispute creates this very necessity of discretion. The next chapter provides a detailed account of how discretion is built-in at every step of this extant legal framework of compensation and damages.

The existing legal framework also lacks an effective means of control against arbitrariness in the exercise of substantive discretion on damages. Arbitrary exercise of procedural discretion that violate applicable procedural rules may be subjected to annulment under Article 52(1) of the ICSID system under various grounds: manifestly exceeding powers[196], serious departure from a fundamental rule of procedure[197], or the failure to state reasons[198]. Similarly, the enforcement of non-ICSID arbitral awards may be challenged under Article V(1)(d) of the New York Convention on such situations of procedural arbitrariness[199]. Additionally, the arbitration law of the seat (*lex arbitri*) may also provide similar or additional grounds for setting aside of non-ICSID awards.

On decisions involving substantive discretion there are no separate grounds on which annulment or setting aside of arbitral awards can be initiated. Though disputing parties have in the past sought to use the largely procedural grounds for annulment under Article 52(1) of the ICSID Convention also on decisions involving substantive discretion, arbitral tribunals have largely shown reluctance to annul awards on such basis[200]. Annulment committees have adapted a high bar for the fulfilment of the grounds for annulment, wherein a review of the correctness of decisions, whether based out of discretion or strict application of law, is usually avoided. The limited scope of review granted by the ICSID Convention in addition to the perception of broad discretion of arbitrators in the decision-making process have contributed to position taken by annulment committees. For example, the annulment committee in *Azurix Corporation v. Argentina* presented the position taken by several previous tribunals on the question of arbitral decision-making on quantum, observing:

[196] Article 52(1)(b) of the ICSID Convention
[197] Article 52(1)(d) of the ICSID Convention
[198] Article 52(1)(e) of the ICSID Convention
[199] Article V(1)(d) of the New York Convention
[200] Schreuer (n 93) 989

> The Committee recalls that it is not a court of appeal, and that it is not the function of the Committee to pass judgment upon the substance of the Tribunal's decision with respect to the quantum of damages[201].

The tendency of annulment committees to avoid engaging with the "substance" of the arbitral tribunal's decisions is in keeping with the mandate of the ICSID system to provide an annulment but not an appellate function[202]. It is only in the most egregious cases of violation of the parties' procedural rights when the tribunal's decision-making (whether on procedure or merits) may be assailed during annulment proceedings. As observed by the annulment committee in *Enron v. Argentina*:

> It is not for an annulment committee to second guess how a tribunal exercises its discretion, unless a particular exercise of discretion amounts to a serious departure from a fundamental rule of procedure.[203]

4.2 Conceiving Discretion as an Inherent Power of Arbitrators

Having explored the constitutive elements of arbitral discretion, it is necessary to see discretion 'at work' in the process of assessing compensation and damages claims in investor-State disputes. Before proceeding with a stage-wise analysis of the same in Chapter 3, it would be useful to briefly consider the categories within which scholarship on international investment law and arbitration seek to place discretionary powers under. The categories of arbitral powers in arbitration are often left undefined in arbitration literature, making it difficult to ascertain the individual sources, nature and scope of the various powers exerted by arbitrators. There has been a renewed interest in recent years within the international arbitration community towards developing a structured understanding of the non-enumerated powers of international arbitral tribunals. Notably, the efforts of the Committee on International Commercial Arbitration of the International Law Association culminated in the presentation of a report regarding the inherent powers of arbitrators in April 2014 (ILA Report)[204]. Let us first consider some of the findings of this report.

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[201] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Decision on the Application for Annulment of the Argentine Republic (1 September 2009)
[202] Schreuer (n 93) 900
[203] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on the Application for Annulment of the Argentine Republic, para 192
[204] Report for the Biennial Conference in Washington D.C. April 2014, International Law Association ('ILA Report')

From ILA Report as well as scholarly works produced consequently[205], the inherent and implied powers of arbitral tribunals have been conceived as a distinct category of powers emanating from the authority of arbitral tribunals, without having to be specifically enumerated in the arbitration agreement or procedural rules[206]. The ILA Report presented the general scheme of arbitral powers under three categories, as described:

> *First*, beyond the express powers of arbitrators, there exist powers implied by the provisions of the parties' arbitration agreement and the other sources selected to govern the arbitration. *Second*, there is a general **discretionary power** over procedure that arbitrators enjoy in the absence of contrary instruction. *Third*, there exists a limited authority to exercise truly **inherent powers**, which arbitrators may employ only if presented with compelling circumstances that risk undermining a tribunal's integrity or compromising the enforceability of its award.[207] (emphasis added)

The Report considers these three forms of powers - implied, discretionary and inherent –though there is significant degree of overlap among them. In scholarship, these powers are generally treated as constitutive parts within a broader conception of inherent powers of international courts and tribunals[208]. The implied powers are relatively clear-cut in terms of what they comprise of – powers that are drawn from enabling provisions in arbitration agreements, procedural rules etc. Discretionary powers are conceptualised in the report as those that may not be strictly based on legal provisions but are considered necessary for the fair and equitable conduct of the arbitral proceedings. The inherent powers, on the other hand, are part of the inherent arbitral authority common to all arbitral tribunals, which are aimed towards protecting the twin aspects of enforceability and the integrity of proceedings. On the subject of discretionary powers, the Report primarily addresses the procedural aspects of discretion. On the general discretionary powers of arbitrators to conduct proceedings, the ILA Report found that the powers in this category share some relation to implied powers, and it may be possible to find a textual basis from which to imply the power to take an action that could also be justified

[205] Franco Ferrari and Friedrich Rosenfeld, *Inherent Powers of Arbitrators* (JurisNet 2019)
[206] ILA Report (n 204) 4
[207] Ibid 14
[208] Chester Brown, The Inherent Powers of International Courts and Tribunals, (2006) 76 British Yearbook of International Law 237-244; Martin Paparinskis, "Inherent Powers of ICSID Tribunals: Broad and Rightly So," in Ian Laird and Todd Weiler (eds.), *Investment Treaty Arbitration and International Law*, 9 (Juris Publishing 2012); Paola Gaeta, Inherent Powers of International Tribunals, in LC Vohrah et al (eds), *Man's Inhumanity to Man: Essays on International Law in Honour of Antonio Cassese* (Kluwer Law International, the Hague 2003); F Weiss, 'Inherent Powers of National and International Courts: the Practice of the US-Iran Claims Tribunal' in C Binder and others (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press, Oxford 2009)

as an exercise of a tribunal's discretion over procedure. These discretionary powers have a clear "inherent" quality, as arbitrators are widely understood to have some inherent degree of control over the efficient conduct of procedure. The findings of a dual implied-inherent qualities of discretionary powers resonates with this chapter's earlier findings, where textual sources (such as procedural rules) as well as internal considerations of fairness and equitable treatment of the disputing parties were seen as the sources for the exercise of discretion. The Report also makes reference to Article 17 of the UNCITRAL Arbitration Rules as an illustration of such textual sources enabling procedural discretion[209].

Although the ILA Report does not address substantive arbitral discretion, the findings regarding the powers exercised viz-a-viz decision-making seem to indicate an implicit recognition of the existence of discretion in this regard. Under the section on 'powers related to decision-making', the Report considers a number of issues like decision-making on jurisdiction, granting relief, awarding damages and apportioning costs. Although the Report considers the decisions made by arbitral tribunal in this respect as an exercise of *inherent* powers, it is submitted that such inherent powers are also discretionary in nature. For instance, the Report refers to the inherent power of arbitral tribunals to award interest as part of an award for damages and notes the practice of the IUSCT in this regard. The award of interest has increasingly been recognised as a crucial aspect of reparation, particularly under the law of State responsibility as in the case of investor-State arbitration. While tribunals may be bound to award interest by law, the rate of interest to be awarded is largely subject to arbitral discretion[210]. On issues such as interest, the discretion of arbitrators has a clear substantive element and is not merely limited to procedure. Although the ILA Report categorises such decision-making as derived from inherent powers, these powers are evidently discretionary in nature.

As also noted in the present research work, the ILA Report highlights the problem of developing an adequate control mechanism on the exercise of inherent powers by arbitrators, including discretion[211]. While powers implied by the terms of the arbitration agreement or procedural rules may be clearer in terms of the limits imposed on the arbitrator's powers, the task is made difficult when considering powers that are assumed to emerge from the arbitral authority of the tribunal. Looking at it from a purposive point of view, it may be argued that inherent powers

[209] ILA Report (n 204) 17
[210] Marboe (n 73) para 6.42
[211] ILA Report (n 204) 19

are necessary for the proper conduct of the proceedings[212] and in decision-making on merits, including addressing issues that may not be directly covered by the applicable law.[213] Consequently, the arbitrators' primary concern would be to exercise their powers in such a manner so that the parties are treated fairly, and the awards passed are enforceable under law. Moses notes that an arbitrator must be mindful of their duty to try to render an enforceable award. In carrying out that duty, it may be found that some necessary powers have not been clearly spelled out in the arbitration agreement. However, the arbitrator must not cross the line that circumscribes their powers, because doing so might be in excess of authority and would render the award unenforceable. Particularly when dealing with issues not within a clearly defined ambit of their powers, arbitrators risk being challenged for bias or for acting beyond the scope of the arbitration agreement.[214]

But how does one determine the limits of such inherent powers that are drawn from broad and admittedly vague conceptions of procedural integrity, enforceability and fairness and equity? In the particular case of arbitral discretion, involving both substantive and procedural aspects, how can existing control mechanisms to arbitration (like ICSID annulment or set aside proceedings before national courts) effectively constrain arbitrariness, incorrectness or exceeding the terms of the agreement in decision-making? Moses describes the range of arbitral powers as comprising aspects of "sunshine and shadow", depending on how clearly the sources and basis of such powers can be determined. Here, the sunny area are powers defined in the arbitration agreement of the parties, in procedural rules adopted by the parties, and in any arbitration law at the seat of the arbitration. On the other hand, there will always be some areas of shadow due to the impossibility of absolute completeness of most agreements, laws, or rules cannot cover every situation where an arbitrator may be required to act. Consequently, many of the laws and rules give broad discretion on merits and procedure to the arbitrator that to be followed in order to achieve a final, enforceable award.

[212] Inka Hanefeld, Aaron De Jong, 'Inherent Powers to Streamline the Proceedings', in Franco Ferrari and Friedrich Rosenfeld (eds.), *Inherent Powers of Arbitrators* (JurisNet 2019) 247-269; Margaret L. Moses, 'Inherent Powers of Arbitrators to Deal with Ethical Issues', in Julio Cesar Betancourt (ed.), *Defining Issues in International Arbitration: Celebrating 100 Years of the Chartered Institute of Arbitrators (*2016) 209

[213] Jeremy K. Sharpe, 'Arbitral Tribunals' Inherent Powers in Corruption Matters', in Franco Ferrari and Friedrich Rosenfeld (eds.), *Inherent Powers of Arbitrators* (JurisNet 2019) 167-195; see also in the same volume, Stefan Kroll, 'Inherent and Implied Powers of Arbitral Tribunals in Connection With Cost-related Decisions', 363-393

[214] Margaret L. Moses, 'Inherent and Implied Powers of Arbitrators' (2014) *Loyola University Chicago School of Law Research Paper No. 2014-015*

Conceiving arbitral discretion as a part of inherent powers of arbitral tribunals may be useful in terms of classification but does not help in answering the question as to what should be its appropriate scope and limits. When conceived purely as a procedural concept, arbitral discretion may be understood more clearly for its gap-filling function and for allowing arbitrators to induce flexibility in the dispute settlement process. Additionally, being largely derived from textual sources, the scope and limits of procedural discretion can be discerned with relative ease. However, the exercise of substantive discretion, particularly in the application of equally esoteric concepts like equity, presents a challenge for scholars and practitioners to comprehend fully. Going forward, we will see the peculiar problems in ascertaining discretion in the context of damages, some of which we have already posed in this chapter.

5. Conclusion

This chapter has provided an overview of the fundamental legal concepts that underpin the exercise of powers, including discretionary powers of tribunals. The legal basis of arbitral authority and arbitral powers in investor-State arbitration can be considered to be derived from the consent of the parties to the arbitration agreement, regardless of whether it is incorporated in the form of a treaty or agreement. The scope of consent of the parties determines the jurisdictional authority of the arbitral tribunal, while conditions of admissibility apply to specific claims in question. While jurisdiction pertains to the inquiry over the existence of arbitral authority, admissibility focuses on the specific claims that are brought for adjudication. In several instances, arbitral tribunals have averted jurisdictional restrictions over claims by re-stating them as questions of admissibility, allowing for greater discretion to admit claims for adjudication.

Following into a deeper assessment of arbitral powers, the research considered the three major sources from which arbitral powers are considered to be derived from: the arbitration agreement, the procedural rules of arbitration and the *lex arbitri*. Each of these sources were examined in turn, covering analysis of various investment treaty provisions as well as a comparative analysis of the major procedural rules: the ICSID Convention (and Arbitral Rules) and the UNCITRAL Arbitration Rules 2010. Each of these sources revealed distinct manners in which procedural and substantive decision-making powers are conferred to arbitral tribunals. The assessment of lex arbitri also revealed the manner in which national courts interact with

international arbitration proceedings and constrain the powers of tribunals by way of mandatory norms.

In the final part of the chapter, the concept of arbitral discretion was explored in its operation of both substantive and procedural aspects in the arbitral process. The distinct sources and application of procedural and substantive discretion were contrasted, and the positions taken by arbitral tribunals, scholars and commentators were presented. The most crucial aspect of this part was to develop the complex relationship between discretion and the assessment of compensation and damages in investor-State arbitration. The role of discretion in resolving complex issues of damages has emerged consistently in investment law jurisprudence. It has been seen that unfettered discretion leaves open a significant possibility for arbitrariness in the decision-making process, compounded by the lack of effective control mechanisms against such improper or arbitrary exercise of discretion, whether on procedural issues or merit.

The study provided a thorough background to the sources of arbitral powers in investor-State arbitration, which will be applied in constructing the role of discretion in the assessment of damages and compensation in the next chapter.

Chapter 3

Discretion in the Determination of Legal Standards and Methods of Valuation

1. Introduction

The function of awarding remedies in the form of compensation and damages is central to the arbitral process in investment disputes. It may be argued that the choice of resorting to dispute resolution is principally driven by the desire among foreign investors to receive compensation for the dispossession or impairment of value of their investments that are caused by state actions. While the determination of state liability for wrongful actions is imperative, it is the availability of legal remedies against such wrongful actions that leads foreign investors to opt for dispute settlement under investment treaties. Therefore, the determination of legal remedies where applicable can be considered to be among the chief duties of investment tribunals. There are principally three categories of cause of action for which claims for compensation and damages arise in international investment law: (i) expropriation of property (ii) breach of international law (iii) breach of investment contracts. The cause of action involved in a dispute also determines a distinct method of compensation, on the basis of which the amount of compensation is determined.

A unique problem in international investment law is in the lack of a treaty-based standard of compensation for breach of international law. While certain state actions like lawful expropriation are subject to treaty-defined compensation standards, there is no guidance within the same treaties regarding the compensation standard for breach of international law, including the breach of incorporated standards of investment protection. Consequently, arbitral tribunals rely on secondary rules like the ILC Draft Articles on State Responsibility to determine the compensation standard for such actions. Tribunals must also identify the valuation methods that most accurately quantify the amount of compensation and damages in fulfilment of the legal standards. Even on this aspect, treaties rarely contain guiding provisions on valuation, leading to the choice of valuation being largely the subject of the arbitrator's discretion, with tribunals choosing among the different valuation models that are submitted by parties and their experts. The lack of specific rules or provisions governing such assessments leads to the assumption of a wide margin of discretion by arbitral tribunals while ascertaining the amount

of compensation and damages, though differing opinion has been offered by tribunals and commentators on the scope of such discretion.

The purpose of this chapter is to examine the various ways in which discretionary decision-making finds its way into the assessment of compensation and damages, and the particular consequences of the extensive reliance on discretion by tribunals. Through a sequential analysis of the various steps in the assessment of compensation and damages, the dual aspects of procedural and substantive discretion are highlighted. Particularly, factors such as the choice of valuation criteria, the rates of pre- and post-award interest rates, investor's contributory fault and other mitigating circumstances etc. and the role of discretion therein is discussed. Analysis of the approaches taken by arbitral tribunals in awards reveals the extent to which discretion, including equity considerations, pervade the decision-making process. However, this chapter is limited to the two primary determinations that lead to the preliminary determination of investment value – the legal standards of compensation and damages and the valuation methods that are accordingly applied. In the next chapter, the post-valuation adjustments are examined in greater detail.

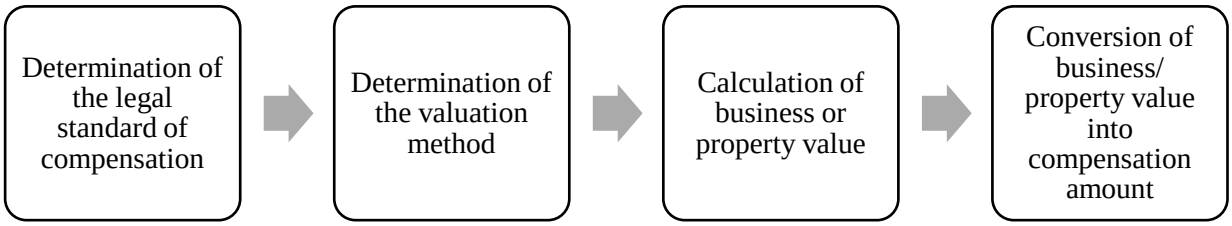
This chapter is organised in the following manner: Section 2 provides an outline to the manner in which issues of compensation and damages are approached in investor-state arbitration. This is followed by an examination of the legal standards used for assessing compensation for expropriation in Section 3, damages for breach of international law in Section 4, and breach of investment contracts in Section 5. The particular problem of assessing lost profits is addressed in Section 6. The chapter then shifts its focus in Section 7 towards the choice of appropriate valuation methods in fulfilment of the legal standards examined earlier. The final component in the assessment process, the application of interest, is detailed in Section 8. The conclusions of this chapter are presented in Section 9.

2. The Structure of Compensation and Damages Assessments

An appreciation of the role of discretion in decision-making necessitates an examination of the process of inquiry of arbitral tribunals in the assessment of compensation and damages. Understanding this 'anatomy of damages' enables one to appreciate the various considerations that are borne by tribunals in quantifying the 'right' amount for compensating the claimants. In an important study on the role of equity-based discretion in the assessment of damages in investment treaty law, Elrifai provided a schematic diagram about the different stages of

assessment[1]. The diagram illustrates the steps identified by Elihu Lauterpacht's study on compensation rules in the case of expropriation of energy investments[2]. The sequence is illustrated as follows:

Figure 1: The sequence of assessment of compensation and damages



This sequence of determinations fairly approximates the line of inquiry followed by tribunals in investor-State arbitrations and also reflects the structure followed by major scholarly works on the calculation of compensation and damages[3]. For instance, Marboe's influential monograph on the subject applies a similar sequential treatment starting with the determination of legal standard for valuation, ascertaining the basis of value, and then followed by the choice of valuation approaches or valuation methods and the final quantification of compensation or damages due[4]. The sequence also highlights the shift that occurs in quantum assessments from a primarily legal analysis (determination of compensation standards) towards more factual and financial analysis (determination and application of valuation methods). This will become more apparent when we deal with each step of the process individually. As a simplified model of the damages assessment process, Figure 1 provides a good point of reference, but does not quite reveal the multiple second-level determinations involved at each step. Keeping this in mind, this chapter will proceed with a structure similar to the sequence, although a clear differentiation among the steps may not be as evident at certain points of inquiry.

[1] Silke Noa Elrifai, 'Equity-Based Discretion and the Anatomy of Damages Assessment in Investment Treaty Law' (2017) 34 Journal of International Arbitration 5, 838

[2] Elihu Lauterpacht, 'Issues of Compensation and Nationality in the Taking of Energy Investments' (1990) 8 Journal of Energy & Natural Resources Law 247

[3] Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (Oxford University Press 2017); Sergey Ripisnky and Kevin Williams, *Damages in International Investment Law* (BIICL 2008); Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (Wolters Kluwer 2008)

[4] Marboe (n 3) para 1.01

2.1 The Distinction between Compensation and Damages

Before proceeding with an examination of the quantification process, it is necessary to clarify the distinction between 'compensation' and 'damages' as applied in this work. While both terms often tend to be used interchangeably within legal sources, drawing a functional difference between them helps in understanding the differences in the manner in which quantum assessments are carried out in each case. In international law literature, the term 'compensation' has been associated most commonly with the payment that are due to property owners by states for the expropriation of property[5]. On the other hand, 'damages' has been used to refer to the broad category of payments for losses arising from the breach of international legal obligations[6]. This mirrors the use of damages to describe the consequences of breach of contract under private law principles, such as the UN Convention on Contracts for the International Sale of Goods (CISG)[7], the Principles of European Contract law (PECL)[8] and more generally under the national contract laws of states. In fact, in international investment law, the standard for quantifying damages for breach of international law is identical to damages for the breach of contract under private law, as will be explored later.

As noted earlier, the distinction between compensation and damages is not observed everywhere. Besides scholarly works, the interchangeable use of terms is also observed in legal sources such as the International Law Commission's ARSIWA. The Commission chose to use compensation for describing the consequences of wrongful state actions under international law. Article 36 of the ARSIWA accordingly states:

> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

[5] SR Ratner, 'Compensation for Expropriations in a World of Investment Treaties: Beyond the Lawful/Unlawful Distinction', (2017) 111 American Journal of International Law 7-56; C.F. Amerasinghe, 'Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice'(1992) 41 International and Comparative Law Quarterly 22-37; C. F. Amerasinghe, 'Some Aspects of the Quantum of Compensation Payable upon Expropriation' (1993) 87 ASIL Proceedings 459; Matti Pellonpää, 'Compensable Claims Before the Tribunal: Expropriation Claims', in Richard B. Lillich & Daniel Barstow Magraw (eds.), *The Iran-United States Claims Tribunal: Its Contribution to the Law of State Responsibility* (Irvington-on-Hudson, N.Y., Transnational 1998) 198–217

[6] Marjorie Whiteman, *Damages in International Law*, vols. I-III (Washington: Government Printing Office, 1937-46). Whiteman's monograph is among the seminal works on the subject from the early 20th century that focuses on the calculation of damages for various breaches of international law.

[7] See Section 74, United Nations Convention on Contracts for the International Sale of Goods

[8] See Article 4:117, Principles of European Contract Law

The use of the term 'damage' here refers to any loss, destruction or impairment of value caused by the internationally wrongful act, that must be made good either by restitution or payment of an equivalent amount of compensation. Despite its use of terminology, it is clear that the ARSIWA is concerned with compensation (along with other forms of reparation) only for State actions that can be construed as an 'internationally wrongful', i.e. in violation of international law. On the other hand, State actions like expropriation of property, when undertaken in accordance with the conditions laid down under the applicable treaty, are not considered to be internationally wrongful acts[9]. Investment treaties therefore envisage two categories of State actions that are compensable in different ways – lawful actions (expropriation of property in accordance with treaty) and wrongful actions (breach of international law). This will be highlighted in more detail when addressing each category of State actions in turn. A wrongful state action is with respect to the breach of investment contracts between States and investors. Breach of investment contracts are also dealt in a manner similar to breach of international law, although the method of assessment of damages may slightly differ[10].

The distinct nature of State actions in cases of lawful expropriation, breach of international law and breach of contract make the distinct usage of 'compensation' and 'damages' a useful method of classification. Therefore, compensation is used in this thesis in reference to the remedy for lawful expropriation, while damages is used in relation to the remedy for breach of international law obligations – whether treaty standards or investment contracts. This classification followed in arbitral proceedings on quantum.[11] The differentiation between cases of compensation and damages was identified by Amerasinghe in terms of lawful and unlawful takings of property. While foreign investor must be compensated in the former case, damages are awarded for the latter. Due to the unlawful nature of takings, damages are usually heavier than compensation[12]. With this in mind, we may now proceed to consider the legal standards for compensation and damages in investment disputes and see if there is any scope for the application of discretion therein.

[9] Marboe (n 3) para 2.38
[10] Ripinsky and Williams (n 3) 104
[11] Marboe (n 3) 2.13. See for instance, *AGIP S.p.A. v. People's Republic of the Congo*, ICSID Case No. ARB/77/1, Award (30 November 1979) (1993) 1 ICSID Reports 30, para 95
[12] Amerasinghe (n 5) 43

2.2 The legal standards of compensation and damages

Identification of the applicable legal standard as the basis for calculation of compensation and damages is usually the first step in the 'quantum' stage of a dispute. Having determined the respondent-State's liability for compensable conduct and the consequent losses, tribunals shift their attention towards quantifying the amount of money that would align the State's liability with the investor's loss[13]. To be clear, payment of monetary compensation is not the only means by which arbitral tribunals may allow reparation for the losses incurred. Restitution, or re-establishment of the *status quo ante*, is recognised as the primary remedy of international law. The ARSIWA seems to create a hierarchy between the different forms of reparation available to the injured party, where restitution is at the pinnacle as the primary form of reparation. The obligation to pay damages is created "insofar as such damage is not made good by restitution" and for providing satisfaction for injury caused only to the extent that it cannot be made good by restitution or compensation[14].

The award of monetary compensation is far more prevalent in investor-State arbitration, due to a range of factors including viability (particularly in cases of expropriation), possibility (States might be able to undo certain actions) and expediency (compensation is usually faster and more easily transferable)[15]. However, it is not necessary here to evaluate the merits of each form of reparation, and it is adequate to conclude that arbitral tribunals may also consider restitution as a remedy in certain cases.

The legal standards for compensation and damages have evolved on the basis of the cause of action involved in a dispute, and it is most convenient to evaluate them separately. The three principal categories of cause of action as already identified are: (i) expropriation of property (ii) breach of international law, and (iii) breach of investment contract.

[13] Wolfgang Alschner, 'Aligning Loss and Liability – Toward an Integrated Assessment of Damages in Investment Arbitration' in Marion Jansen, Theresa Carpenter and Joost Pauwelyn (eds.), *The Use of Economics in International Trade and Investment Disputes* (Cambridge University Press 2017)
[14] James Crawford, *State Responsibility: The General Part* (Cambridge University Press 2013) 507-08.
[15] For a discussion on additional considerations, see Borzu Sabahi, *Compensation and Restitution in Investor-State Arbitration*, (Oxford University Press 2011) 61-90

3. Expropriation of Property

The expropriation of property by the state has been the subject of some of the earliest disputes under the international law on foreign investment[16]. Long considered as an important part of the 'international minimum standard' for treatment of foreigners, the customary legal standard of expropriation began to be incorporated within the earliest investment treaties in the 20th century[17]. In principle, expropriation of foreign property is considered to be a lawful act, and part of the sovereign rights of the state. However, the legality of such expropriation is subject to certain conditions that have developed over several decades. It is now commonly understood that expropriation of foreign investor's property must be in the public interest, non-discriminatory, in accordance with due process of law and accompanied by payment of compensation[18]. The lawfulness of expropriation is an important point of distinction, particularly with respect to the legal standard of compensation that applies consequently. Investment treaties generally state the conditions for lawful expropriation along with the standard of compensation that must be paid to the foreign investor. For instance, the 2012 US Model BIT incorporates the conditions for expropriation under Article 6(1) to make all forms of expropriation unlawful unless it satisfies the conditions of (a) public purpose; (b) non-discriminatory treatment (c) payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and the Minimum Standard of Treatment incorporated in Article 5 of the BIT.[19]

Additionally, the model text also prescribes certain conditions regarding the payment of compensation under Article 6(2), which provides that (a) payments be made without delay; (b) it must be equivalent to the fair market value of the expropriated investment immediately before the date of expropriation; (c) it does not reflect any change in value occurring because the intended expropriation had become known earlier; and (d) must be fully realizable and freely transferable[20]. The conditions regarding payment of compensation are as relevant as fair conduct for determining the lawfulness of the expropriating action. In legal scholarship, conditions for expropriation are termed as 'conduct requirements', and the conditions for compensation are referred to as the 'compensation requirements'[21]. While the conduct

[16] August Reinisch and Christoph Schreuer, *International Protection of Investments: The Substantive Standards* (Cambridge University Press 2020)
[17] Ibid 16
[18] Marboe (n 3) para 3.05
[19] Article 6(1), 2012 US Model BIT
[20] Article 6(2), 2012 US Model BIT
[21] Ripinsky and Williams (n 3) 66

requirements (public purpose, non-discriminatory, due process) are by themselves largely uncontroversial, the compensation requirements have been the subject of significant debate, particularly with respect to their relevance for the lawfulness of the expropriation[22]. Secondly, there was disagreement regarding the customary international law standard for compensation arising from expropriation. Prior to the introduction of treaty-based standards of compensation, the debate over customary international standard become quite active and controversial.

3.1. Customary International Law

States have had a varied understanding about the legal standard that must be applied in assessing the amount of compensation due for lawful expropriations of foreign property by the host State. Debates regarding the appropriate compensation standard for takings point to the differing approaches of national governments in Europe and the United States, as well as in the practice of international arbitral commissions and courts[23]. Beginning in the 1930s, the United States pioneered the standard of 'prompt, adequate and effective' for compensation - famously referred to as the Hull formula[24]. There were various standards adopted by states, such as 'full' and 'just' compensation for lawful takings, although these approaches primarily focussed on the preservation of capital and the rights of foreign investors/property owners[25]. Until the Second World War and the large-scale decolonisation that followed, the tendency towards protection and preservation of foreign capital continued to be the predominant approach[26].

The emergence of newly independent countries through the post-war period gave rise to radically new voices. At international forums such as the United Nations, many postcolonial states united towards asserting their sovereign rights over property and natural resources, including the rights of nationalisation and expropriation of property[27]. The issue of compensation particularly divided opinion between industrialised, capital-exporting states and non-industrialised, developing states, many of whom had recently emerged from the shadows of colonial rule. While most Western states insisted on full compensation for expropriation of

[22] Marboe (n 3) para 3.05
[23] Oscar Schachter, 'Compensation for Expropriation'(1984) 78 American Journal of International Law 1, 121-130
[24] The so-called Hull Formula as the standard for compensation largely emerged out of US treaty practice in the 20th century. The origin of the Hull Formula lay in the demands made by US Secretary of State Cordell Hull to the Mexican government in 1938 due to the large-scale expropriations that were being carried out by Mexico as a part of its land reform measures.
[25] M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2012) 414
[26] Ibid.
[27] R. Higgins, 'The Taking of Property by the State' (1982) 176 Hague Recueil 259

property as the appropriate legal standard, the opinion of developing economies ranged between considerations of 'appropriate' compensation that was subject to the host State's decision-making[28]. For instance, the efforts of developing countries to establish a New International Economic Order (NIEO) was marked with resolutions passed before the UN General Assembly, including an assertion of 'appropriate compensation' as the standard for expropriation of property under international law[29]. The standard of appropriate compensation sought to provide a wider consideration for the State's economic and developmental interests in determining the appropriate level of compensation. This would also include the relevant domestic laws and regulations and other pertinent concerns. On the other hand, the proponents of the full compensation standard sought that the principal consideration should be the value of the taking and the loss incurred by the property-owner in determining the compensation due. Sornarajah aptly highlighted the implications of adopting an appropriate compensation standard as a flexible standard that ranges from the payment of full compensation, the amount of future profits lost, to the payment of no compensation where the foreign investor had clearly earned inordinate profits from its investment while host state has had no benefits at all from the investment. Sornarajah also drew attention to the resolutions made by the New International Economic Order in the 1960s that were founded on appeals to justice and equity that are themselves rooted in international law. Consequently, compensation must meet the supranational standards of appropriateness and must be justifiable in terms the considerations of justice and equity[30].

Notwithstanding the differing positions of states on the appropriate standard of compensation for lawful expropriation under customary international law, the modern practice of international courts and tribunals has largely settled on certain principles. The jurisprudence developed in the context of the Iran-United States Claims Tribunal (IUSCT) has been particularly influential in this regard. The Tribunal in cases such as *INA Corporation v. Iran* provided detailed opinion on its position regarding the appropriate standard of compensation when evaluating cases of expropriation[31]. Opining on the desirability of considering all the relevant circumstances, including the economic status of the host state while awarding compensation, Judge Lagergren observed in his separate opinion that the principle of "appropriate compensation" must take into

[28] Sornarajah (n 25) 445
[29] United Nations General Assembly Resolution on the Permanent Sovereignty over Natural Resources, Resolution No. 1803 (XVII) (14 December 1962)
[30] Sornarajah (n 25) 446
[31] *INA Corporation v. The Government of the Islamic Republic of Iran*, IUSCT Case No. 161, Award No. 184-161-1 (13 August 1985)

account of all relevant circumstances and constitutes the correct legal standard for large-scale nationalisations of commercial enterprises that are of fundamental importance to the nation's economy where the Hull standard would be inadequate[32]. Notably, Judge Lagergren also observed the proximity between differently worded compensation standards, and the discretion that is available to judges and arbitrators while interpreting them. He noted that the use of terms "appropriate", "equitable", "fair" and "just" to be essentially interchangeable with regard to compensation. Adjudicators have a wide choice of methods of valuation that are applicable and appropriate under different circumstances. Even the notions "full" and "adequate" compensation contain grant a "margin of uncertainty and discretion"[33].

Judge Lagergren agreed to the use of 'appropriate compensation' standard as the correct standard in the context of large-scale nationalisations being conducted particularly in countries like Iran which were undergoing radical economic change in those years. He further approved the use of fair market value method for calculating compensation on this basis, after having discounted for all the relevant circumstances involved. This position was particularly important as it became the standard position for arbitral tribunals in later years. While Judge Lagergren's Separate Opinion was countered by Judge Holtzmann in his own opinion in support of the full compensation principle, the consideration of financial position of the host State and other relevant circumstances has been considered by several tribunals while awarding compensation.

An important point to note here is what Judge Lagergren described as the inevitability of uncertainty and discretion in the application of the customary standards of fair or adequate compensation in the valuation process. After all, if tribunals are supposed to inquire into broad considerations such as the economic condition of the host state, the conditions leading to expropriation etc. they are bound to have subjective perceptions over the factors affecting the compensation value. Without specific guidelines, tribunals are likely to make decisions on a discretionary basis. The IUSCT in *Shahin Shaine Ebrahimi v. Iran* made a similar observation regarding the flexibility within in the 'appropriate' compensation standard. The tribunal noted that this allows the amount of compensation to be determined in a flexible manner, which takes into account the specific circumstances of each case. However, the "appropriate" compensation

[32] Separate Opinion of Judge Lagergren, *INA Corporation v. The Government of the Islamic Republic of Iran*, para 10
[33] Ibid para 12

standard does not imply that the compensation quantum should be always "less than full" or always "partial"[34].

The flexibility afforded to tribunals leads to the assumption where tribunals determine what constitutes 'appropriate' compensation in the circumstances of each particular case. Additionally, arbitrators may also rule on the basis of equitable considerations, particularly where decision-making proves to be difficult for the tribunal[35]. As we will see in the next section, concerns regarding wide discretion of tribunals under the customary international standard are largely ameliorated by the emergence of treaty-based standards of compensation in BITs and other instruments.

3.2. Investment Treaty Standards

The emergence of treaty-based standards for compensation in the investment regime meant that the debate over customary international standards lost much of its relevance. Interpretation of the treaty standard of compensation attained greater importance over the more vaguely constructed customary law standard. However, treaties have used different terms while incorporating compensation standards. For example, the United States in its treaty practice has uniformly adopted the Hull formula of 'prompt, adequate and effective compensation' over the years, as noted earlier. The Hull formula has also been widely adopted by other states and remains the most common standard, including treaties concluded between developing countries[36]. Other treaties have made variable use of 'just compensation', 'fair and equitable compensation' or simply 'compensation' for expropriation[37].

Greater certainty with regard to the method of calculating compensation has been made possible with the addition of the 'fair market value' standard of valuation in treaties. As noted earlier in Article 6(2) of the 2012 US Model BIT, the conditions of paying compensation without delay, on a fair market value basis and calculated prior to the date of expropriation provides arbitral tribunals with a well-defined method for awarding compensation. A more recent restatement of

[34] *Shahin Shaine Ebrahimi and others v. The Government of the Islamic Republic of Iran*, IUSCT Case Nos. 44, 46 and 47 Final Award (Award No. 560-44/46/47-3) (12 October 1994)
[35] Ripinsky and Williams (n 3) 77
[36] Ibid 78
[37] Marboe (n 3) para 3.16-3.17

the clause is incorporated in the recent EU-Viet Nam Investment Protection Agreement. Article 2.7.2[38].

Fair market value is a valuation standard rather than a legal standard for compensation that provides a clear-cut guidance to arbitral tribunals on the assessment of compensation. Unlike legal standards of compensation, valuation standards like 'fair value' require little interpretation on the part of arbitral tribunals[39]. Thus, by drawing an equivalence with valuation standards in the provision on compensation, investment treaties have allowed for greater certainty of assessments. Further, recent treaty practice of some states have added additional guidance regarding the valuation *criteria* in addition to the valuation standard. For example, the 2015 Indian Model BIT provides a non-exhaustive list of valuation criteria, including going concern value and asset value. States have largely settled on the incorporation of legal and valuation standards that provide greater certainty to the process of assessing compensation. Although some variations of terminology may be noted in the different BITs, such as 'full value', 'market value' and 'actual value' among others, the process of calculation is functionally the same.

The reason for the increased incorporation of valuation standards legal standards in expropriation clauses may be attributed to the World Bank's publication of its Guidelines on the Treatment of Foreign Investment in 1992[40]. Firstly. the Guidelines provided that compensation would be deemed "appropriate" if it were in accordance with the Hull formula of adequate, effective and prompt compensation[41]. This interpretation of 'appropriate compensation' in effect reduces the wide scope of discretion granted under the customary international law. Instead of allowing tribunals to determine within a broader scale of compensation, the World Bank's formulation of appropriate compensation is narrowed down to a higher standard. Secondly, the Guidelines provide that 'adequate' compensation under the Hull formula is tied to the fair market value of the property or asset taken by the state[42]. While treaties do not refer directly to the World Bank Guidelines regarding expropriation, the rise in the number of BITs that incorporated clauses along these suggestions suggest that the guidelines had a significant influence on state practice regarding investment treaties[43]. According to the ICSID tribunal in *Tidewater v. Venezuela*, the World Bank Guidelines provide reasonable

[38] Article 2.7.2, EU-Viet Nam Investment Protection Agreement
[39] Ripinsky and Williams (n 3) 79
[40] World Bank Group, *Legal Framework for the Treatment of Foreign Investment Volume II: Guidelines*, Report No. 11415 (1992)
[41] Guideline IV.2
[42] Guidelines IV.3
[43] Reinisch and Schreuer (n 16) 231

guidance regarding the content of the standard chosen by the signatory states to the BIT as the standard of compensation to be applied in cases of lawful compensation, where the investment is a going concern at the time of the taking. The Tribunal also found the Guidelines to be consistent with the standard of fair compensation that is required by customary international law in the case of a lawful expropriation[44].

The incorporation of specific treaty standards for lawful expropriation indicates a movement away from discretion-based determination to a structured mechanism. This has certainly been aided by the World Bank Guidelines, with arbitral tribunals making references to the same in in their pronouncements on compensation[45]. From the question of the legal standard of compensation, there has been a shift in debate over recent years towards the application of the valuation criteria and methods. Where specific guidelines are not provided in the treaty texts, tribunals may be required to compare among the value of the taking calculated under different methods, such as income and asset-based approaches.

3.3 Compensation and the Lawfulness of Expropriation

The discussion so far on the customary law and the treaty-based standards of compensation for expropriation have been with respect to compensation deemed lawful. However, compensation that is in breach of customary international law or of the treaty standards brings in a different form of liability, i.e. the liability to pay damages. Understanding the difference is crucial also because expropriation in breach of international law attracts significantly higher financial liability than for expropriation undertaken in accordance with international law. The obvious rationale for this difference lies in the fact that while the former is an internationally wrongful act, the latter is a lawful act that is permitted under international law. Sornarajah stresses on the importance of differentiating a wrong or injury which requires compensation by way of remedy from a justifiable act that requires any person who has been adversely affected as a result is compensated through payment of monetary damages[46].

While the rationale is quite obvious, international investment treaties have largely been silent on the consequences flowing from unlawful expropriations, particularly with respect to the damages payable in such cases. The approach that has been adopted in arbitral practice to award

[44] *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Award (30 March 2015) para 152
[45] Marboe (n 3) 3.24
[46] Sornarajah (n 25) 414-415

damages for breach of international law. The ICSID Tribunal in *ADC v. Hungary* set out its now famous position in the following terms:

> …in the present case the BIT does not stipulate any rules relating to damages payable in the case of an unlawful expropriation. The BIT only stipulates the standard of compensation that is payable in the case of a lawful expropriation, and these 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[47]

The tribunal further observed that as the BIT did not contain any *lex specialis* governing the standard for assessing damages in the case of an unlawful expropriation, it is therefore necessary to apply the customary international law in the present case[48]. What is important to note here though is that the lawfulness of the expropriation becomes a crucial determinant of the legal standard as well as the valuation methodology to be used for quantifying the reparation that is due to the expropriated investor. While the calculation of compensation for lawful expropriation focuses primarily on the replacement value of the subject investment or property, damages under the full reparation principle aims undo the loss suffered by the foreign investor. Consequently, the calculation of damages is a more subjective exercise than compensation for lawful expropriation[49].

Under investment treaties, both of the conduct and compensation requirements are deemed as prerequisites to the lawfulness of expropriation. However, there has been a continuing debate among scholars, practitioners and policy makers about whether the payment of compensation can be considered as an independent condition for the lawfulness of expropriation[50]. Simply stated, does non-payment of compensation by the state to the foreign investor render the state's expropriation unlawful? The second question that arises here is the consequential effect of the lawful/unlawful distinction on the compensation or damages that is awarded by arbitral tribunals. Does unlawful expropriation necessary imply that tribunals must pay damages?

In a manner similar to the debate on the standard of compensation, the question of state compensation as a condition for lawfulness of expropriation divided opinion between former colonial and capital-exporting states and newly independent, capital-importing states after the

[47] *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award (2 October 2006) para 481
[48] Ibid para 483
[49] Marboe (n 3) 2.97
[50] Ripinsky and Williams (n 3) 83

Second World War[51]. While scholarly opinion in the western industrialised states supported the award of full compensation as a necessary condition for lawful expropriation, resistance to this approach arose in formerly colonised states where significant foreign investment originating from the western states was located. The UN General Assembly's 'Resolution of the Permanent Sovereignty over Natural Resources' of 1962 was also a part of the emerging competing norms[52].

The opinion of scholars on the subject has also varied. Classic texts on the principles of international investment law such as by Dolzer and Schreuer place an equivalent importance to payment of compensation as conduct for the lawfulness of compensation[53]. Others, like Mohebi, hold that non-payment does not directly render an act of expropriation to be unlawful. Rather, non-payment would amount to a breach of an independent duty to the property owners that applies in cases of both lawful and unlawful expropriation[54]. Marboe notes a shift in opinion on the subject in recent years, where there seems to be an increasing consensus that the state's offer for compensation or determination of an amount of compensation at the time of expropriation is sufficient to show the lawfulness of the expropriating act. While the question of compensation is important in determining lawfulness or unlawfulness of the taking, existence of a dispute regarding the *amount* of such compensation does not render the expropriation to be unlawful.

But the more relevant question with regard to investment arbitration is about how arbitral tribunals should differentiate between lawful and unlawful expropriation, particularly considering that investment treaties usually do not differentiate the same. The position of the tribunal in *ADC v. Hungary* of resorting to 'full reparation' under customary international law has already been noted. This rationale follows that unlawful expropriation is evidently an internationally wrongful act, for which the customary international law standard is full reparation. This standard, as also incorporated in the ARSIWA, marks a shift from a treaty-based standard of reparation towards a patently unlawful action by the state. Therefore, we will examine it further in the next section - cause of action arising from breach of international law.

[51] Sornarajah (n 25) 443. See also, Andreas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008) 494.
[52] Sornarajah (n 25) 444-445.
[53] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 99-100
[54] M Mohebi, *The International Law Character of the Iran-United States Claims Tribunal* (Kluwer Law International 1999) 289.

4. Breach of International Law

The liability of states for internationally lawful actions or conduct is based out of the norms of customary international law. Certain obligation of states towards foreigners arise under customary international law - what is commonly referred to as the international minimum standard[55]. Beginning with the era of BITs and other investment instruments in the 1950s, the standards of treatment by host states of foreign investors and their investments began to be incorporated as express 'standards'. Along with setting the conditions for expropriation of foreign-owned property, these investment treaties defined standards for national treatment, most-favoured-nation treatment (MFN), fair and equal treatment - including full protection and security - among others[56]. In many cases, investment contracts signed between governments or their agencies with foreign investors have enjoyed the protection of international law under overarching investment treaties[57]. Thus, there has been a progressive standardisation and codification of the international law obligations driven by the rapid growth in the number of investment treaties worldwide.

The international law standards for investment protection as well as the remedies for their breach (restitution and/or damages) are incorporated in most investment treaties. However, treaties do not specify the rules for awarding damages arising from breach of international law standards for investment protection. Consequently, arbitral tribunals must refer to the rules of customary international law to identify the legal standard for damages arising from internationally wrongful acts. For this purpose, arbitral tribunals commonly refer to two principal sources: (i) the 1928 judgement of the Permanent Court of International Justice (PCIJ) in the *Chorzów Factory* case[58], and (ii) the codified customary law principles of state responsibility in the 2001 ILC Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA). The PCIJ in *Chorzów Factory* pronounced the legal standard of 'full reparation' for damages arising from internationally wrongful acts of states, i.e. acts in violation of international law. Eventually, the full reparation standard was eventually codified in the ARSIWA.

[55] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford University Press 2013); T. Weiler, *The Interpretation of International Investment Law: Equality, Discrimination and Minimums Standards of Treatment in Historical Context* (Oxford University Press 2013)

[56] August Reinisch, Christoph Schreuer, *International Protection of Investments: The Substantive Standards*, (Cambridge University Press 2020); Campbell McLachlan, Laurence Shore, and Matthew Weiniger, *International Investment Arbitration Substantive Principles,* (Oxford University Press 2nd ed. 2017)

[57] Jean Ho, *State Responsibility for Breaches of Investment Contracts* (Cambridge University Press 2018)

[58] *The Factory at Chorzów (Germany v. Poland) (Claim for Indemnity) (Merits)* (1928) PCIJ Series A No. 17, 4

4.1. Full Reparation

The full reparation standard mandates that an injured party must be placed in the same position they would have been in if the wrongful act had not been committed by the party in breach. As famously stated by the PCIJ in the *Chorzów Factory* case:

> 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 reestablish the situation which would, in all probability, have existed if that act had not been committed[59]. (emphasis added)

The case before the PCIJ concerned the German government's suit for reparation arising from Poland's seizure of a German-owned nitrate factory located in Chorzów in Upper Silesia. This was in alleged violation of the German-Polish Convention on Upper Silesia, also known as the Geneva Convention, of 15 May 1922. A crucial aspect of this case was that the expropriation of the factory by Poland was not a lawful taking, but an act in breach of the Geneva Convention. While the cause of action in this case was principally of expropriation of foreign-owned property, the PCIJ's finding that the expropriation was an internationally wrongful act carried important consequences for assessment of damages that followed. In establishing a clear distinction between the compensation owed for lawful expropriation and damages for wrongful state actions, the Court observed that Poland's unlawful actions did not merely amount to an expropriation for which fair compensation would be necessary. It constituted a seizure of property, rights and interests which could not be expropriated even against compensation. Consequently, the compensation that was due to the German government could not be limited only to the value of the undertaking at the moment of expropriation[60].

The heightened liability and the consequential damages for a wrongful act as opposed to lawful expropriation was thus clearly laid out by the PCIJ. Full reparation goes further than compensation for lawful expropriation in attempting to restore the foreign investor's likely position or its equivalent financial value had the breach not occurred. Therefore, the assessment of damages based on the full reparation standard involves a subjective assessment of the claimant-investor's financial position, instead of only the value of the investment in dispute. In contrast, lawful expropriation cases largely involve compensation for the value of the investment taken over by the state, and thereby involves an objective standard of assessment.

[59] Ibid 47
[60] Ibid 46

Marboe classifies the resulting valuation methods as 'objective-abstract' valuation for lawful expropriation, and 'subjective-concrete' valuation for internationally wrongful acts[61].

The PCIJ made another set of important observations in its judgement regarding the manner in which reparation for breach of international law would need to be made. The Court placed a clear preference for restitution as the primary remedy under international law on the following terms. However, where restitution is not possible, it must be accompanied by a sum that corresponds to the value of restitution of the property[62].

The two essential components to damages for international wrongful acts as described by the PCIJ are: (i) restitution of property or its equivalent value, and (ii) additional damages for loss sustained due to the wrongful act. It is the second component of additional damages that marks the distinction between compensation for wrongful acts as opposed to lawful compensation - the necessity to wipe out all the consequences of the illegal act. These damages may include factors such as consequential damages, costs for remedying the breach, mitigating damages, loss of value of the investment etc. It is this subjective element of the losses incurred by the injured party that differentiates internationally wrongful acts from lawful state acts that are envisaged under investment treaties. This full reparation standard also marks the crucial distinction between lawful and unlawful expropriation because unlawful expropriations are effectively internationally wrongful acts that must be compensated accordingly. This distinction has historically not been made by states under most investment treaties, leading to the practice of applying the treaty-based standard of compensation for lawful expropriation even in unlawful expropriation cases[63].

Although the views of the PCIJ in *Chorzów Factory* had supported having the distinct full reparation standard for unlawful expropriation, the practice of tribunals had been inconsistent. Prior to the awards in *ADC v. Hungary* (2006) and *Siemens v. Argentina* (2007)[64], the effect of lawful/unlawful distinction on compensation observed in *Chorzów Factory* had not been applied by investor-state tribunals[65]. Its subsequent revival particularly based on the views in *ADC v. Hungary* significantly influenced tribunal practice in favour of applying the full

[61] Marboe (n 3) para 2.98
[62] Ibid
[63] Borzu Sabahi, *Compensation and Restitution in Investor-State Arbitration* (Oxford University Press 2011) 99-100
[64] *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8 Award (17 January 2007)
[65] Charles N. Brower & Michael Ottolenghi, 'Damages in Investor-State Arbitration' (2007) 4 Transnational Dispute Management 6

reparation standard in cases where expropriation was found to be unlawful[66]. Despite this, a conclusive pronouncement on this issue is still elusive. The lawful/unlawful distinction may lose relevance in choosing the appropriate valuation criteria and methods for calculating compensation. Certain valuation methods may result in the same amount of compensation irrespective of the compensation standard chosen. Additionally, the amount of compensation may also be higher in cases where the compensation standard for lawful expropriation is applied instead of full reparation. Some commentators have consequently questioned the usefulness of maintaining a distinction between lawful and unlawful expropriation[67]. This is explored further in the section on valuation criteria.

The general acceptance of the PCIJ's pronouncements in *Chorzów Factory* as a matter of customary international law was reflected in their codification within the 2001 ARSIWA. Article 31 codifies the principle of reparation as follows:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

Under Article 34, the ARSIWA recognises three forms of reparation for breach of international law: restitution, compensation and satisfaction. It is quite apparent that the articles on reparation and compensation codify the principles laid down in *Chorzów Factory* and subsequently followed by international courts and tribunals. The commentaries to the ARSIWA also attest to the influence of the PCIJ's judgement in *Chorzów Factory* that was subsequently reaffirmed by the International Court of Justice, European Court of Human Rights, investment tribunals and other bodies[68]. However, the ARSIWA does not specify how full reparation must be given effect by courts and tribunals. Crawford notes that during the drafting process, there was some controversy regarding the obligation regarding the inclusion of the term 'full reparation', particularly given that it did not account for the state's capacity to pay[69]. However, the Drafting Committee decided to retain the term without any qualifications as it considered that there had

[66] *Yukos Universal Ltd. v. Russian Federation*, UNCITRAL, PCA Case No. AA 227 (July 18, 2014); *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)
[67] Ratner (n 5) 7
[68] See commentaries to Article 31 and 36, Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA), with commentaries 2001, *Yearbook of the International Law Commission,* 2001, Vol. II, Part Two.
[69] Crawford (n 14) 481

not been a significant extent of criticism against the same[70]. Despite the disagreements on the qualifications to full reparation, it was widely accepted that the standard required wiping out the consequences of the unlawful act as stated in *Chorzów Factory*[71]. By numerous references to the case in its commentary to reparation, the Drafting Committee indicated its agreement with the scope of full reparation as laid out in *Chorzów Factory.* In investor-state arbitrations, the ILC's formulation and the *Chorzów* standard has been widely adopted by tribunals while considering the full compensation standard for damages.

4.2. Application of Full Reparation

The application of the full reparation standard for reparation requires arbitral tribunals to consider a hypothetical scenario for the claimant-investor where the wrongful act has not been committed by the respondent-state. This arises from the *Chorzów Factory* dictum of re-establishing "the situation which would, in all probability, have existed if that act had not been committed". Ideally, this would be achieved through the primary remedy of restitution of the *status quo ante* prior to the commission of the internationally wrongful act. Under Article 35 of the ARSIWA, restitution could take either the form of *material* restitution – restoration of the investment value that existed prior to the unlawful act – or by *juridical* restitution - restoring the legal situation that existed prior to the commission of the unlawful act[72]. However, given the various difficulties associated to restitution as mentioned earlier, the secondary remedy of damages are far more commonly awarded by tribunals. Since damages must perform a function equivalent to restitution, it logically follows that calculation of the amount of damages must also factor the assumption of the claimant-investor's situation in absence of the internationally wrongful act.

Article 36 of the ARSIWA does not provide much guidance beyond a general formulation providing compensation for damages. The Article states that:

> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

[70] ibid
[71] Ibid
[72] Sabahi (n 99) 61

Firstly, Article 36(1) establishes damages (termed as 'monetary compensation') as a secondary remedy to restitution. Therefore, where restitution is not possible or inadequate, damages can compensate the injured party. it is also stated that damages must be in the form that is "financially assessable" under Article 36(2). Though not expressly defined in the Articles, the commentaries provide that financially assessable damages to nationals include both material (damage to property, loss of earnings, loss of value, etc.) and non-material damages (pain and suffering, loss of loved ones etc.)[73]. Further, such damages may also include lost profits of the injured party provided that such losses can be established to the satisfaction of adjudicating authority.

The general nature of the full reparation standard delineated under the ARSIWA places significant discretion on arbitral tribunals regarding the manner in which it is given effect. Arbitral tribunals exercise their substantive discretion in determining whether a valuation method satisfies the dual conditions of (i) wiping out all the consequences of the internationally unlawful act and (ii) restoring the probable condition that would have existed without the commission of the said unlawful act, as set out in *Chorzów Factory*. The most commonly used approach by tribunals has been in applying a counterfactual test to assess what the claimant-investor's situation would have been, in all probability, if the internationally unlawful act had not been committed. This approach is commonly termed as the *differential hypothesis* or the *but-for* premise[74]. This method of determining damages has been recognised in legal systems as early as the 19th century. Marboe attributes the development of this method to the writings of German scholar Friedrich Mommsen in 1855, where he termed it as the 'Differenzemethode' ('differential method')[75]. Others have referred to the basis for calculating damages in cases related to contract damages as developed by courts as early as the leading English case of *Robinson v. Harman* (1848)[76]. The judgement of the English court laid down the principle as follows:

> The rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.

[73] Crawford (n 14) 517. Notably, if an injured state seeks to claim compensation directly from the injuring state, it may only do so for material damages. The remedy for immaterial damages suffered by states can be pursued in the form of satisfaction under Article 37 of the ARSIWA

[74] Herfried Wöss and Adriana San Román, 'Full Compensation, Full Reparation and the But-For Premise' in John A Trenor, *Global Arbitration Review Guide to Damages in International Arbitration* (Law Business Research Ltd. 2018)

[75] Marboe (n 3) para 2.107.

[76] *Robinson v. Harman* (1848) 13 P.D. 191 (C.A.), 200

Often termed as the *expectation interest*, the private law principle of contract damages aims to protect the expectation of benefit from the performance of the contract that would have accrued to the injured party but-for the breach[77]. Therefore, the quantum of damages awarded to the injured party must include the benefit of the performance of the contract in the form of lost profits (or *lucrum cessans*) in addition to the direct losses (or *damnum emergens*) arising from the breach of contract. Under French and German private law, damages for breach of contract are assessed in a similar basis. The French principle of *reparation intégrale* mandates returning the victim as closely 'as monetarily possible to the position in which he would have been had the wrong not been done'[78]. Under the German civil code, the rule on damages provides that 'a person who is liable in damages must restore the position that would exist if the circumstance obliging him to pay damages had not occurred'[79]. In international contracting principles such as UNIDROIT Principles of International Commercial Contracts (UPICC)[80] and the UN Convention on Contracts for the International Sale of Goods (CISG)[81], the differential approach is similarly adopted in giving effect to the full reparation principle.

Although contract damages is often used as an analogy, the differential method applied under the full reparation principle for breach of international law is functionally more akin to how damages under tort law is awarded. Although both tort and contract law within the private law systems set the full reparation for damages, they differ in terms of the approach towards achieving full compensation. Compensatory damages for tort liability seeks to place the injured party in a position before the tort was committed, while contract damages seeks to place the injured party in a (contractual) post-performance situation[82]. As the investment protection obligations under treaties are international legal obligations rather than contractual, their breach does not create a contractual liability to compensate the injured foreign investor. Instead, breach of international law is similar to the breach of a 'duty of care' that host states owe to the foreign investor in a manner similar to a tort obligation. Consequently, some commentators have argued that the standards of investment protection under treaties is essentially the codification of international tort law standards[83]. However, when it comes to the practical aspect of damages

[77] Mark Pettit Jr., 'Private Advantage and Public Power: Re-examining the Expectation and Reliance Interests in Contract Damages' (1987) 28 Hastings Law Journal 3, 417
[78] Solène Rowan, *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance* (Oxford University Press 2012) 109
[79] Section 249(1) Bürgerliches Gesetzbuch
[80] Article 7.4.2 UPICC
[81] Article 74 CISG
[82] Simon Deakin and Zoe Adams, *Markesinis and Deakin's Tort Law*, 8th ed. (Oxford University Press 2018) at 800
[83] Herfried Wöss, 'Systemic Aspects and the Need for Codification of International Tort Law Standards in Investment Arbitration' (2016) Transnational Dispute Management, TDM 1

assessment for breach of investment protection standards, the tort-contract differentiation has no bearing in the determination of state liability.

There are essentially three steps of determination that must be made in under differential or 'but-for' analysis:

1) *The 'breach' position* - The arbitral tribunal determines the claimant-investor's position due to the injury caused by the respondent-state's unlawful act.
2) *The 'non-breach' position or 'but-for' scenario* - The arbitral tribunal determines the claimant-investor's most likely position in the absence of the unlawful act and the resulting injury that was caused. The date for establishing the investor's position, or the valuation date, is usually the date of the award, though it may differ in some cases.
3) *The difference* – The difference between the 'non-breach' position and the 'breach' position constitutes the effects of the injury caused by the wrongful act that must be compensated by the payment of an equivalent amount of damages.

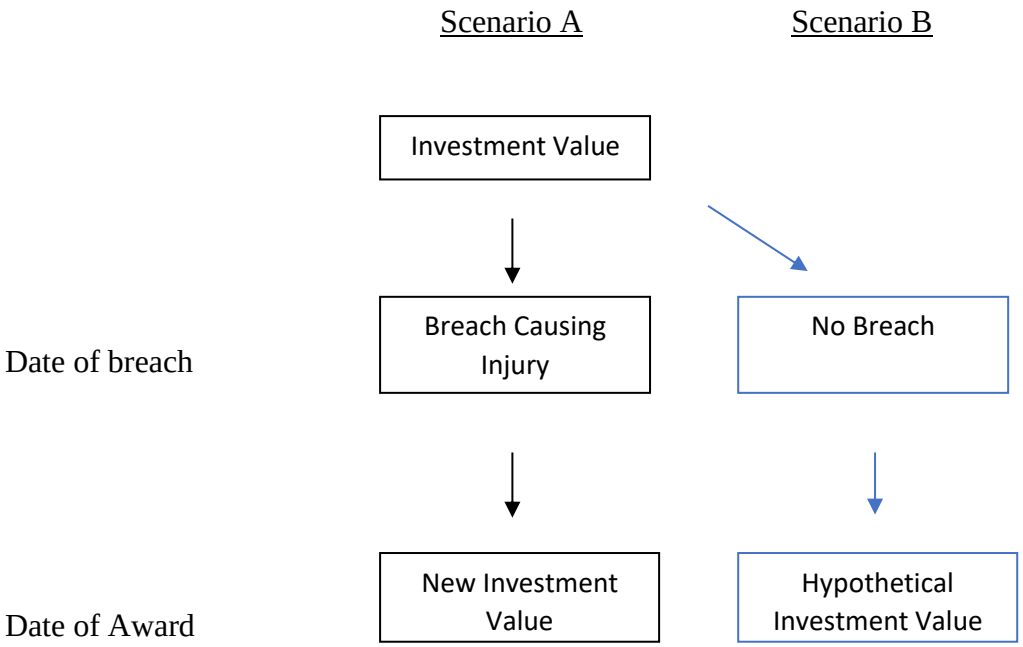


Figure 2: Differential or but-for scenario for calculating damages

Figure 2 illustrates the differential method, where Scenario A represents the actual situation where a breach of international law has caused injury that has led to a change of value of the investment. On the other hand, Scenario B represents a purely hypothetical situation where no breach or resultant injury was caused to affect the value of the investment. The hypothetical

investment value represents the most probable value of the investment that would have been in such as non-breach scenario. Consequently, the amount of damages is equivalent to the difference between the value of the investment between Scenario B and A on the date of the award. By paying the difference to the injured investor, the respondent-state would effectively be placing them in a situation where the breach of international law and the resulting injury had not occurred, thereby also wiping out the consequences of the breach. The particular role of discretion lies in the arbitral tribunal's determination of the most probable 'but-for' scenario. The determination of the correct causal factors becomes an important task in this regard, as the respondent state can only be held liable if there is a causal linkage between the breach and the subsequent injury caused. Additional factors like the claimant-investor's efforts at mitigating losses, and other causes for adjustment to damages are also crucial towards determining the right amount of damages. These will be considered later in this chapter.

Arbitral tribunals in investment disputes have affirmed their discretion while giving effect to the full reparation standard in the absence of any particular valuation methods specified in the treaties. For instance, the arbitral tribunal in *S. D. Myers v. Canada* noted in its findings that although the North American Free Trade Agreement (NAFTA) prescribed the fair market value as the basis for calculating compensation for expropriation, no such criteria was prescribed for calculating damages. Consequently, the tribunal observed that by not providing a specific methodology for calculating damages due to breach of international law, the NAFTA drafters intended to leave it open to the arbitral tribunals to determine a method of assessing compensation that was appropriate to the specific circumstances of the case taking into account the principles of both international law and the NAFTA[84].

Further, the Tribunal observed that regardless of the particular valuation method used for calculating damages, such method must 'undo the material harm inflicted by a breach of an international obligation'[85]. Since the type and extent of harm can vary from case to case, the method of calculation of damages should also be determined accordingly. This can be contrasted with lawful expropriation of property, which is a more standardised form of state action involving the taking of property or investment. Consequently, most expropriation clauses in treaties are tied to a singular standard such as fair market value while provisions on damages are left open-ended in terms of the method of valuation that may be applied.

[84] *S.D. Myers, Inc. v. Government of Canada*, First Partial Award (13 November 2000) para 309
[85] Ibid para 315

Some arbitral tribunals have used the flexibility of the full reparation standard to even award damages for breach of international law based on the compensation for lawful expropriation standard. For instance, the ICSID Tribunal in *Wena Hotels v. Egypt* held the respondent state liable for its failure to provide fair and equitable treatment and full protection and security to the claimant's investment under the Egypt-UK BIT[86]. Additionally, the respondent was also held liable for unlawful expropriation by failing to provide prompt, adequate and effective compensation for the expropriation of the claimant's property[87]. Despite these liabilities arising from breach of international law, the tribunal decided to award damages based on the compensation for lawful expropriation under Article 5 of the BIT. The Tribunal did not provide any specific reasoning for the choice of valuation but merely re-stated Article 5, which provides that compensation for expropriation must be equivalent to the market value of the investment immediately before expropriation. On this basis, the tribunal awarded damages equivalent to the amount that had been invested by the claimant along with interest.

The arbitral award was eventually challenged under ICSID annulment proceedings by the respondent[88]. Although the arbitral tribunal's decision of calculate damages based on the compensation criteria was not challenged, the respondent objected to the amount of damages and the interest rate on the grounds of serious departure from fundamental rules of procedure and failure to state reasons under Article 52 of the ICSID Convention. This was eventually dismissed by the annulment committee on its findings of sufficient reasoning and fair exercise of discretion by the arbitral tribunal[89].

The award in *Wena Hotels v. Egypt* is by no means an exception. Tribunals in a number of cases have deemed it fit to award damages for breach of international law using the compensation for lawful expropriation method, despite the distinctions of lawfulness and subjective/objective valuation criteria discussed earlier. A reasoning that is frequently adopted by tribunals is based on the effects of the act. For example, the tribunal in *Metaclad v. Mexico* reasoned that the difference between damages for violation of the NAFTA's investment protection standards and compensation for lawful expropriation did not matter in the particular case. This was because the claimant-investor had lost their investment completely due to the respondent state's alleged

[86] Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Arab Republic of Egypt for the Promotion and Protection of Investments (signed 11 June 1975, entered into force 24 February 1976)
[87] *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (3 December 2000) para 77
[88] *Wena Hotels Ltd. v. Arab Republic of Egypt*, Decision on the Application by the Arab Republic of Egypt for Annulment of the Arbitral Award (5 February 2002)
[89] Ibid para 65, 92 and 96

actions[90]. The cumulative effect of the unlawful state actions in the case had been equivalent to the taking of property, and therefore, had to be compensated by payment of the fair market value of the property. In the more recent case of *Gold Reserve v. Venezuela*, the arbitral tribunal noted that the respondent-state's unlawful actions had an effect similar to the *Metaclad* case - total deprivation of the investor's rights over their investment[91]. Consequently, the tribunal held in agreement with both of the disputing parties' submissions that the amount of damages must be equivalent to the fair market value of the investment on the date of breach of the fair and equitable treatment standard[92].

Beyond breaches causing full loss of investment value, Ripinsky and Williams have identified five other forms of losses that are compensated variably by tribunals: (i) diminution in investment's value (ii) unpaid taxes or contract price (iii) loss of dividends by shareholders (iv) loss due to temporary interference and (v) loss of invested amounts[93]. For each type of loss, arbitral tribunals have applied valuation methods that would fulfil the full reparation standard. In addition, disputes may also involve multiple violations of treaty standards, such as breach of fair and equitable treatment in addition to denial of justice or breach of national treatment provisions. The approach of tribunals in calculating damages, however, is to calculate total damages arising from all breaches together, instead of separate damages for individual treaty violations. However, the most crucial aspect to remember is the wide flexibility of tribunals to identify the most appropriate approach in fulfilling the applicable legal standard of damages.

4.3 Moral Damages

As the discussion so far has been about material damages, it is necessary here to also make a comment regarding the award of non-material damages in investor-state arbitration, generally referred to as 'moral damages'[94]. Although moral damages are recognised under domestic and international law and jurisprudence, including Article 31 of the ARSIWA[95], they have not been

[90] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000) at para 113
[91] *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award (22 September 2014) para 681
[92] Ibid para 680
[93] Ripinsky and Williams (n 3) 92
[94] Patrick Dunberry, 'Moral Damages', in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) at 142; Juan Pablo Moyano García, 'Moral Damages in Investment Arbitration: Diverging Trends'(2015) 6 Journal of International Dispute Settlement 3
[95] Crawford (n 14) 486

as frequently awarded in investor-state arbitration. Arbitral tribunals have awarded moral damages in very few cases[96], despite the fact that moral damages have been frequently claimed by parties in investment disputes.

Sabahi has described three forms of moral damages that can be distinguished: (i) Damage to personality rights of individuals - non-material harm that can be suffered by natural persons (ii) Damage to reputation - This may have a dual character of both material and non-material harm, and (iii) Legal damage - Harm caused *ipso facto* by violation of international obligation[97]. While each of these types of damages can have distinct factors and consequences, the more relevant question in the present discussion is the basis for awarding moral damages and the method of calculation.

While the tribunal in *Benvenuti v. Congo* in 1980 was the first investor-state tribunal to award moral damages, it had been empowered to make the rule *ex aequo et bono,* which it did by awarding 5 million CFA (equivalent to 72,000 USD today) on an equitable basis for the "intangible loss" suffered by the claimant. It was in *Desert Line v. Yemen* where moral damages were awarded for the first time thereafter. According to Marboe, the high threshold for awarding moral damages established by the *Desert Line* tribunal is the reason for the lack of awards on moral damages[98]. The Tribunal held moral damages as a remedy to be awarded in exceptional circumstances[99].

The tribunal further took into consideration the fact that malicious manner in which the Claimant was placed under physical duress, which was constitutive of a fault-based liability[100]. Though the tribunal agreed with the Claimant regarding the substantial prejudice suffered, it declined the substantial sum of about 104 million USD claimed and instead awarded USD 1 million as an appropriate amount. Notably, no interest was applied to the amount as the tribunal considered it to be a discretionary amount[101]. The rationale applied by the tribunal in this case influenced many subsequent tribunals thereafter, most notable of which was *Lemire v.*

[96] *S.A.R.L. Benvenuti & Bonfant v. People's Republic of the Congo*, ICSID Case No. ARB/77/2 Award (8 August 1980*); Desert Line Projects LLC v The Republic of Yemen*, ICSID Case No ARB/05/17, Award (6 February 2008); *Mohamed Abdulmohsen Al-Kharafi & Sons Co v Libya and others*, Award (22 March 2013); *Bernhard von Pezold and Others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15 Award (28 July 2015)

[97] Borzu Sabahi, *Compensation and Restitution in Investor-State Arbitration*, (Oxford University Press 2011) at 136

[98] Marboe (n 3) 5.353

[99] *Desert Line Projects LLC v. The Republic of Yemen*, Supra Note 105 at para 289.

[100] Ibid para 290.

[101] Ibid para 297. However, 5% interest was to be awarded if the Respondent failed to pay the sum within 30 days of the award.

Ukraine[102]. Though no moral damages were awarded in this case, the tribunal developed a criteria that though moral damages are not available to a party as a general rule, it can be awarded in exceptional cases, provided that: (1) the state's actions imply a physical threat, illegal detention or other situations in which the action breaches the norms according to which "civilized nations" are expected to act (2) the state's actions lead to deterioration of health, stress, anxiety, or any other mental suffering and (3) both cause and effect are grave or substantial.

Though many subsequent tribunals have affirmed to the *Lemire* criteria, exceptions like the *Arif v. Moldova*[103] award has indicated differing approaches to how tribunals should assess questions like what would constitute "exceptional circumstances" for awarding moral damages. The *Arif* tribunal agreed only with the second and third factors laid down in *Lemire* criteria as it "left the Tribunal with an element of discretion, but within the general framework that moral damages are an exceptional remedy"[104]. The tribunal also stressed the importance of restricting moral damages to a high standard of exceptional cases to avoid creating financial advantages for the victim that went beyond the traditional concept of compensation[105].

While the approach of awarding moral damages in exceptional cases has largely been accepted, the method by which any such damages must be calculated remains uncertain. As in the case of *Lemire v. Ukraine* and *Benvenuti v. Congo*, the tribunal in the more recent case of *Bernhard von Pezold v. Zimbabwe* also followed a discretionary approach in determining quantum. The Claimants had requested a total amount of USD 17 million as moral damages due to various threats and violence that had been meted out to them. Although the tribunal agreed that the grounds and the evidence attested by the claimants satisfied the criteria for awarding moral damages in accordance with the *Desert Line* and *Lemire* positions, it held that the amount requested to be excessive[106]. Applying the same considerations as used in *Desert Line*, along with a stated aim for "some consistency with other ICSID decisions", it determined $2 million in total to the Claimants as the appropriate amount. Additionally, the tribunal decided not to award interest on the moral damages[107].

Therefore, the approach of tribunals to awarding monetary damages seems to be largely discretionary in nature. This discretion lies not only with respect to quantum, but also for deciding whether a certain claim fulfils the "exceptional case" principle. The tribunal in *Arif v.*

[102] *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18 Award (28 March 2011)
[103] *Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23 Award (8 April 2013)
[104] Ibid para 591
[105] Ibid para 592.
[106] *Bernhard von Pezold and Others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15 Award (28 July 2015) para 921.
[107] Ibid para 942

Moldova observed in this regard that the line between a mere breach and grave and substantial pain and suffering can be determined only by an appreciation of the facts of the case[108].

Moral damages can have material and non-material consequences. Where moral damages are largely material in nature, such as loss of reputation leading to decrease in business value, and the valuation method account for such factors, separate moral damages are unnecessary. However, where non-material consequences are largely non-material, such as pain and suffering, these will not be reflected in the valuation. In fact, any precise quantification of such harm using mathematical tools is unlikely in such an event. However, the arbitral tribunal cannot refuse moral damages on such a basis. As famously held in the *Lusitania* case, non-material injury must be remedied under international law[109]. As with the case of damages in general, the lack of certainty in quantifying non-material injury should not be a ground for not awarding any damages at all. Consequently, commentators have recognised the wide margin of discretion that lie with arbitral tribunals in quantifying such elements[110].

5. Breach of Investment Contracts

The third type of cause of action arising in the context of investment disputes comprises of breach of contracts between foreign investors and host states. Some common forms of such investment contracts include natural resource concessions, public service concessions, build-operate-and-transfer contracts and public–private partnerships, the duration of which are often spread over several years[111]. Investment contracts have played a dominant role in regulating foreign investment flows globally and continue to be an important source of foreign investment protection. Prior to the proliferation of investor-state disputes under investment treaties, investment contracts were the primary source of foreign investor claims against host states[112]. Although investment treaties have largely become the principal legal instruments on which foreign investors base their claims, contracts continue to play an important role. In the absence of pre-existing investment treaties, contracts become the primary legal instrument for foreign investors to have international legal protection over their investments[113].

[108] *Arif v. Moldova* (n 103) para 603
[109] *Lusitania (United States v Germany)*, Administrative Decision No II, 1 November 1923, in UN Reports of International Arbitral Awards, Mixed Claims Commission (United States and Germany), 1 November 1923–30 October 1939, vol VII, 26.
[110] Ripinsky and Williams (n 3) 312
[111] Jean Ho (n 57)
[112] Sornarajah (n 25) 276
[113] Ibid 278

In choosing the applicable law of contract, foreign investors can negotiate from among a variety of domestic legal regimes or incorporate international legal protections. The law of damages arising from the breach of investment contracts would consequently vary on the basis of the applicable law that was incorporated into the contract. Investors who are already protected under an existing treaty and having entered into investment contracts with the same host state could elect for the treaty-based route for settling contractual claims. This is made possible by the incorporation of the so-called 'umbrella' clauses in certain investment treaties that allow breach of contract claims by protected investors to be elevated to breach of investment treaty standards[114]. For example, if a state breaches its investment contract with a foreign investor by a discriminatory act, the investor could pursue its contractual claim as a breach of investment treaty claim, such as the fair and equitable treatment. Consequently, the remedy for the breach would be based on the legal standard incorporated in the treaty, which is usually the full reparation standard.

In contractual disputes that are not raised as treaty-based claims, the terms of the applicable law of the contract are the principal determinants of the damages that can be awarded thereunder. However, applicable law clauses can themselves be quite complex, often incorporating more than one domestic law or general principles of law and international law in addition to domestic law[115]. In some cases, the applicable law may not have been incorporated into the contract, resulting in tribunals interpreting the choice of the parties. In ICSID arbitrations, tribunals must follow the provisions governing the applicable law under Article 42(1) of the ICSID Convention, stated as follows:

> The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

Despite the possible multiplicity of sources governing applicable law, some aspects governing damages are largely recognised under most legal systems and have been settled within investment arbitration. The concept of full compensation, which mirrors the full reparation principle for damages has been widely accepted for calculating contract damages under international law[116]. In one of the most influential awards involving state contracts involving oil exploration, *Sapphire v. NIOC*, the arbitral tribunal affirmed the common law principle of

[114] Stephan W. Schill, *International Investment Law and Comparative Public Law* (Oxford University Press 2010)
[115] Marboe (n 3) para 3.176
[116] Ripinsky and Williams (n 3) 105

expectation damages as a general principle of law. The tribunal affirmed the respondent's liability to place the claimant "in the same pecuniary position that they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion."[117]. Despite the nature of the contractual relationship in the dispute being between a sovereign and a private entity, the tribunal affirmed the applicability of *pacta sunt servanda* ("all agreements must be kept") as a general principle of law that bound contractual relationship between the parties. Therefore, the award of damages for breach of contract was a natural consequence of the contractual promise of the respondent to the claimant. The similarity between full compensation under the *Sapphire* arbitration and the full reparation principle applied by the PCIJ in *Chorzów Factory* is an important indication toward the private law origin of both principles that was expanded to govern contractual and international legal relationships between sovereign states and individuals. This similarity has also been observed by ICSID tribunals on issues governing damages[118].

Having considered the commonly applied standard for damages for breach of contract, tribunals must turn to the question of actual calculation. The classical method for calculating damages is based on the determination of *damnum emergens* and *lucrum cessans* as the two components of compensation[119]. The two components allow for a convenient conception of the types of losses suffered in breach of contract cases – costs of breach and the benefits foregone. *Damnum emergens* comprises of the direct injury suffered by the non-breaching party as a consequence of the breach of contract, including the expenses or costs incurred by the party in performing its part of the contractual obligations. *Damnum emergens* therefore represents the reliance interest of the injured party that has undertaken specific obligations under the terms of the contract. On the other hand, *lucrum cessans* refers to the expected profit or benefit that the injured party had expected from the performance of the contract but has been foregone due to the breach. In essence, *lucrum cessans* represents the lost profits that would have accrued to the injured party if the contract would have been performed. The combined effect of these two components fulfils the function of placing the injured party in a *post-performance* situation, wherein the injured party has recuperated the costs of performing the contract along with the net profit that would have accrued from the performance.

[117] *Sapphire International Petroleum Ltd. v. National Iranian Oil Company*, 35 I.L.R. 136 (1963) at 185-186
[118] For instance, see *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1 Award in re-submitted proceeding, (31 May 1990) para 183-184
[119] John Y. Gotanda, 'Damages in Private International Law' (2007) 326 *Recueil des Cours* 83, 185-86

Although the function and the differences between *damnum emergence* and *lucrum cessans* are conceptually easy to comprehend, there can be a number of complexities raised in the process of assessment. The first problem lies with reliably quantifying damages under the *damnum emergens* and *lucrum cessans*. Direct losses, including the incidental costs incurred by the claimant, are relatively easy to calculate. For example, in a claim for breach of a typical build-operate-transfer (BOT) contract, the costs incurred by the claimant in terms of construction, labour, capital etc. are usually recorded reliably and available in the firm's accounts. Additionally, such contracts carry detailed estimates of costs and expenses that are negotiated between disputing parties. However, the component of lost profits, or *lucrum cessans*, by its very nature of being an estimated figure, can prove to be difficult to establish. Particularly in the case of new projects that do not have a reliable record of performance or return, arbitral tribunals have shown a divergence on the question of awarding lost profits[120].

6. Lost Profits

The award of lost profits is an issue that is relevant to the award of damages under international law as well as for breach of investment contracts. Under international law, Article 36(2) of ARSIWA makes it amply clear that where lost profits are financially assessable, they must be awarded as apart of compensation for damages[121]. In disputes involving breach of investment contracts, the component of *lucrum cessans* covers the lost profits that must be awarded to the injured party along with *damnum emergens*. Under the domestic law of most jurisdictions, lost profits are considered as a crucial component of contract damages, although the manner of awarding them may vary[122]. As noted earlier, it may be difficult to establish lost profits with certainty as many assumptions must be made regarding the profitability of the injured party, particularly in the absence of past performance. Arbitral tribunals have exercised significant discretion when deciding claims made for lost profits. In cases involving high uncertainty regarding lost profits, tribunals have made varied decisions ranging from awarding nominal or equitable amounts or even refusing lost profits outright[123]. The ILC commentary to the ARSIWA notes that lost profits have not been as commonly awarded as losses arising directly

[120] John Y. Gotanda, Assessing Damages in International Commercial Arbitration: A Comparison with Investment Treaty Disputes, (2007) 4 Transnational Dispute Management 6

[121] Article 36(2) of the ARSIWA states that: 'The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.'

[122] Adam Kramer, *The Law of Contract Damages* (Bloomsbury 2nd ed. 2017) 18-05

[123] In the specific instance of ICSID arbitrations, see George H Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal: An Analysis of the Decisions of the Tribunal* (Oxford University Press 1996) 294

out of the injury. The reluctance to award lost profits may be explained by the speculative nature of assessing their quantum. Where tribunals have decided to award damages, it is in instances where there has been enough evidence to determine that the income that was anticipated by the injured party could be considered to be legally protected. For instance, this could arise under contractual arrangements, or where there is a history of such transactions[124].

The ILC's views focused on the particular distinction that was necessary between lost profits that were too speculative from those which could be established more reliably, particularly in commercial relationships with a history of performance or where the terms of the breached contract had established a definite source of income for the injured party over a given period of time. It must also be noted that the ARSIWA was finalised in 2001 based on the practice of international courts and arbitral tribunals until then. In the last twenty years, the practice of investor-state arbitral tribunals has advanced rapidly regarding issues such as lost profits. It has become common for arbitral tribunals to award lost profits where they are established with reasonable certainty. The tools for assessing lost profits have also evolved and are more in line with market-oriented mechanisms, as we will see further. At the same time, tribunals continue to refer to older awards and scholarly pronouncements while deciding on lost profits claims. Whiteman makes an important observation in this regard:

> In order to be allowable, prospective profits must not be too speculative, contingent, uncertain, and the like. There must be proof that they were reasonably anticipated; and that the profits anticipated were probable and not merely possible[125]. (emphasis added)

The decision regarding the speculative nature of lost profits would have to be made by the arbitral tribunal based on the submissions of the disputing parties. The question regarding 'reasonable anticipation' of profit, and how the tribunal would interpret the same thus became an important factor towards the decision to grant the amount of lost profits. Investment contracts provided a source for determining reasonable anticipation, as the contractual terms generally secured a stream of income over a defined period.

[124] Commentary on Article 36 ARSIWA
[125] Whiteman (n 6) 1837

6.1 Categories of Lost Profits

The ILC commentary also defined three distinct categories of lost profits[126]. Firstly, lost profits would have to be determined where the unlawful act led to a temporary loss of use or enjoyment of the income producing asset (or investment) due to the unlawful act. This would involve a comparison with the estimated income that the injured party would have received absent the temporary interference with their investment. Secondly, lost profits would have to be calculated in cases where the unlawful act led to taking of legal title to the investment or an equivalent effect, that would have to be calculated between the date of the taking and up to the date of the arbitral award. This category would be applicable to the instances of unlawful expropriation that amounted to breach of international law.

The third category of lost profits is regarding lost *future* profits, which would be awarded for losses anticipated after the date of the award. The purpose of awarding lost future profits is to compensate the injured party/claimant investor for the anticipated income that was would have been gained for the term of the contract had it not been breached. For instance, if an investment contract for operating a mine or a factory between 2005 and 2015 was breached in 2008, the injured party's stream of income assured by the contract from 2008 and 2015 would have to be protected. However, the benefits of the contract in terms of lost profits could only be awarded until the injured party's protected interests were extinguished[127]. Thus, if the contract was lawfully terminated at any time during the period of performance, the claimant cannot be awarded lost profits beyond the termination date. In breach of international law or breach of contract cases that did not amount to taking of property, the first and third categories of lost profits are in consideration.

Arbitral tribunals have observed the practical difficulties of assessing lost profits. The ICSID tribunal in *LETCO v. Republic of Liberia* observed how the determination of loss of future profits is an often-complicated exercise. Although there is bound to be some imprecision, it does not mean that the arbitral tribunal should refuse to award lost profits altogether. It is sufficient to use "reasonable and consistent" criteria in determining future profits[128]. The tribunal's observation echoed Lauterpacht's views made more than half a century ago on the necessity of awarding lost profits as an integral part of damages:

[126] Commentary on Article 36 ARSIWA
[127] Crawford (n 14) 522-23.
[128] *Liberian Eastern Timber Corporation v. Republic of Liberia*, ICSID Case No. ARB/83/2 (31 March 1986) para 101

> The border line between direct and indirect damages, or between prospective and speculative profits, is seldom clear, and its determination is often dependent upon the subjective estimate of the arbitrator, who is, in fact, guided not so much by the technical distinctions between different kinds of damages, as by the wish, perfectly justified in law, to afford full redress to the injured. But to maintain that international law disregards altogether compensation for lucrum cessans is as repellent to justice and common sense, as it is out of accord with the practice of international tribunals[129].

Lauterpacht's views provide an important point of consideration for arbitral tribunals while facing claims for lost profits. Although tribunals must give effect to the aspect of lucrum cessans on one hand while avoiding speculative awards on the other, the first point of consideration lies with the determination of whether lost profits exist. Uncertainty exists in terms of the *quantum* of lost profits as well as whether the injured party is eligible to receive lost profits. If the latter is clearly established, then uncertainty regarding the quantum should not prevent tribunals from awarding lost profits. However, if no incidence of lost profits arise within the dispute, then tribunals can safely reject any claims made regarding the same. This position was also put forward by Gotanda in opining that amount of lost profits does not need to be established with certainty. Placing such an express requirement would create an almost insurmountable burden on the claimant while benefiting the injurer that caused the damage. As long as the claimant shows with "reasonable certainty" that profits would have been made without the respondent's unlawful actions, the claimant only needs to provide a basis upon which a tribunal can reasonably estimate the extent of loss of profits[130].

Gotanda's views support the notion that the burden of proof for demonstrating the *amount* of lost profits should be lighter than for demonstrating the *existence* of lost profits. Consequently, where it is sufficiently shown that the claimant would have made profits but for the unlawful state action, mere uncertainty regarding the quantum of lost profits should not be a ground for refusal to award lost profits. Arbitral tribunals have increasingly proceeded on this basis in recent years, though opinion has diverged on the criteria for evaluating the existence and quantum of lost profits[131].

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[129] Hersch Lauterpacht, *Private Law Sources and Analogies of International Law* (Longmans Green and Co. Ltd. 1927) at 148-49

[130] John Y. Gotanda, 'Assessing Damages in International Commercial Arbitration: A Comparison with Investment Treaty Disputes' (2007) 4 Transnational Dispute Management 6, 5

[131] Patrick W. Pearsall and J. Benton Heath, 'Causation and Injury in Investor-State Arbitration' in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018)

6.2 Discretionary Approach to Lost Profits

Investment treaties usually make no specifications regarding the assessment of lost profits, and their basis is usually found on Article 36(2) of the ARSIWA as a part of secondary obligations of states to compensate for breach of international law. Investment contracts may incorporate terms limiting the amount of damages, including lost profits, though this is fairly uncommon in practice[132]. Consequently, the decision to award a certain amount of lost profits is determined by the criteria set by arbitral tribunals[133]. The two core aspects that are considered by most arbitral tribunals while awarding lost profits are *causal link* and *reasonable certainty*[134]. The requirement of a causal link is essential to tying together the damage caused with the relevant unlawful state action. States are only liable to the extent that their action have led to losses, and the causal chain leading to the damages must be clearly established. This aspect is discussed in more detail in the section on causation below.

Reasonable certainty of losses follows from the notion that lost profits should not be too speculative. Following Whiteman's analogy as stated earlier, arbitral tribunals attempt to establish with reasonable certainty that the anticipated profits were "probable and not merely possible". Reasonable certainty must be distinguished from burden of proof standards such as 'beyond reasonable doubt', which entail a high standard of proof that would be impossible to establish when used for estimates such as lost profits. Instead, reasonable certainty would imply that profits would be probable given the facts and evidence adduced in the dispute. The 'balance of probabilities' standard of proof that is applied by arbitral tribunals for assessing damages claims also applies to lost profits[135]. The ICSID Tribunal in *Hrvatska Elektroprivreda v. Slovenia* observed that the standard of proof for claimant to show it has suffered loss is the balance of probabilities. While the evidence adduced should not be speculative or uncertain, scientific certainty is also not necessary. The tribunal will have some degree of estimation in considering the counterfactual scenario, and the fact that there is some estimation does not mean that the burden of proof is not satisfied[136].

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[132] Gabrielle Nater-Bass and Stefanie Pfisterer, 'Contractual Limitations on Damages' in John A Trenor, *Global Arbitration Review Guide to Damages in International Arbitration,* (Law Business Research Ltd. 3rd ed. 2018)
[133] Marboe (n 3) 3.210
[134] Ripinsky and Williams (n 3) 115
[135] Frederic G Sourgens, Kabir AN Duggal and Ian A Laird, *Evidence in International Investment Arbitration* (OUP 2018) 83-84
[136] *Hrvatska Elektroprivreda d.d. v. Republic of Slovenia*, ICSID Case No. ARB/05/24 Award (17 December 2015) para 175

This is tribunal's position is visible in the reasoning adopted in awards that involve mid and long-term investment projects that are new, lacking any significant history of profitability or yet to begin commercial operation[137]. Among some such disputes, the IUSCT award in *Levitt v. Iran* is notable for the tribunal's refusal to grant lost profits based on the estimates contained in the claimant's business proposal documents where only preliminary work had been completed[138]. The same rationale of refusing lost profits based on unreliable estimates for new or yet-be-operational projects was applied in ICSID cases like *Autopista Concesionada v. Venezuela*[139] and *Metaclad v. Mexico*[140], among others.

Similar caution was also applied by tribunals in applying forward-looking valuation criteria like the discounted cash flow (DCF) method. The DCF method is used for estimating the fair market value of an investment, where its current value is represented as a sum of its future cash flows[141]. While the use of DCF is examined in more detail in the later sections, it is sufficient to note here that the method is built on an assumption of future income generated by an investment. Naturally, such assessments can be highly speculative when used in the context of new investments with little or no record of earnings. Several tribunals in the past rejected claims for lost profits based on DCF-based fair market value assessments of investments that were yet to be in operation or whose value diverged greatly from the sunk costs of the investment. For example, the ICSID Tribunal in *Wena Hotels Ltd. v. Egypt*[142], rejected the claimant's request for lost profits and lost opportunity of £45.7 million due to the largely speculative nature of the assessment, given that the Claimant's investment in two hotels hardly had any operational record. One hotel had been operating for less than 18 months, while the other had not been fully renovated before they were illegally expropriated. Additionally, the tribunal noted the wide disparity between the claimant's stated investment in the two hotels of US$8.8 million from the amount claimed as lost profits as further grounds for rejecting the claim as being too

[137] Marboe (n 3) para 3.213
[138] *William J. Levitt v. The Government of the Islamic Republic of Iran & Others*, IUSCT Case No. 209, Award No. 297-209-1 (22 April 1987)
[139] *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5 Award (23 September 2003) para 351
[140] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1 Award (30 August 2000) para 122
[141] Kai F. Schumacher and Henner Klönne, 'Discounted Cash Flow Method', in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) at 205
[142] *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4 Award, (Dec. 8, 2000), 41 I.L.M. 896 para 124

speculative. Similar approaches had been earlier adopted by tribunals on lost profits claims using DCF in *Metaclad v. Mexico* and *SPP (Middle East) v. Egypt*[143].

The understanding of reasonable certainty and the speculative nature of lost profits has certainly shifted with the greater acceptance of DCF-based assessments in recent years. As some arbitral awards suggest, tribunals seem to be more inclined to award damages (including lost profits) even for new businesses that have no record of profitability. For example, in *Gold Reserve v. Venezuela*[144], the ICSID Tribunal agreed to apply the DCF method for assessing the value of a mine that had yet to come under operation based on the reasoning that nature of the investment in question was a commodity, whose cash flows could be reasonably estimated based on market data and price predictions. Relying on the certainty of the underlying value of the deposits in the mine, the tribunal accepted the DCF method. This was also the approach taken by the tribunal in *Tethyan Copper Company v. Pakistan*[145], wherein a modified DCF approach was adopted for valuing a copper and gold mine, despite the fact that the mine never came into operation. Although in both *Tethyan* and *Gold Reserve*, the common factor of underlying mineral value could be considered as a more reliable factor for valuation, the tribunal's approach is certainly in contrast to the more cautious and position taken by tribunals in the 1990s and early 2000s. The *Gold Reserve* tribunal's reference to the 'margin of discretion' in awarding damages explains the flexible approach taken by tribunals in interpreting the reasonable certainty of lost profits and damages[146].

As with the various legal standards of compensation and damages, we have seen that arbitral discretion plays a substantial role in the decision of awarding lost profits and their quantum. The legal standards contained in investment treaties and secondary rules like the ILC's ARSIWA are quite broad and vague in nature. Consequently, arbitral tribunals have stepped in to develop various tests and standards over the years for interpreting and giving effect to the legal standards. For instance, the principle of full reparation as laid down in the *Chorzów Factory* case continues to define arbitral practice till today, almost 100 years since the PCIJ's judgement. Despite the lack of a formal rule of precedent in investor-state arbitration, most tribunals refer to past awards and judgements while deciding the applicable standards for

[143] *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3 Award (20 May 1992)
[144] *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1 Award (22 September 2014)
[145] *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, ICSID Case No. ARB/12/1 Award (12 July 2019)
[146] *Gold Reserve v. Venezuela* (n 144) para 686

compensation and damages. Further, while there is a broad consensus among arbitral tribunals regarding the applicable legal standards based on the cause of action, the approaches used to give effect to the standards can vary significantly. This will become clearer in the next section on the use of various valuation methods by arbitral tribunals.

7. Valuation Methods

Once the task of determining the appropriate legal standard for compensation or damages has been determined, the arbitral tribunal's work moves towards the actual process of calculation of compensation or damages due. The question of the appropriate valuation method can be quite contentious, with disputing parties often presenting detailed submissions and evidence in support of their position in this regard. This is particularly the case where the facts and available evidence may be more suited to a certain valuation method than the other. In an ideal scenario, the choice of valuation method should have a minimal impact on the final value once a specific valuation basis, such as fair market value or full reparation, has been determined by the arbitral tribunal. In fact, a wide divergence between valuation methods applied for the same valuation basis acts as an indicator to arbitral tribunals of errors in the calculation process[147]. However, in real-life adjudication, the disputing parties are willing to use all the necessary arguments and approaches to support a valuation that is more favourable to them, even where the difference in valuation is not too significant. In cases involving high stakes, the 'battle of experts' on valuation has become the norm, with an ever-increasing role of expert evidence and testimony in the arbitral process[148].

Arbitral discretion has a crucial role to play here, as the decision regarding the appropriate valuation method falls squarely on the tribunal. There is no guidance available to arbitrators from the legal sources, other than the requirement that the valuation approach must fit the legal standard of compensation or damages that is applicable to the dispute. Discretion is not limited to the choice of valuation method in itself. Tribunals often ask for adjustments to be made to the valuations submitted by the parties in order to account for specific fact patterns or evidence presented in a case. Often, factors external to the legal dispute must be considered as well. For example, the quantification of country risk as an external factor affecting the value of an

[147] Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (Wolters Kluwer 2008) 27

[148] Nigel Blackaby and Alex Wilbraham, 'Practical Issues Relating to the Use of Expert Evidence in Investment Treaty Arbitration' (2016) 31 ICSID Review 3 655

investment often arises in cases involving DCF-based valuations[149]. Since such questions pertain to financial rather than legal decision-making, arbitral tribunals are tasked with making an informed decision based on the information available. Although parties and their experts might present various evidence in support of their position, it is up to the tribunal's discretion to examine the relevance and weight of the evidence and decide accordingly. While parties may refer to prior arbitral practice regarding such non-legal considerations, tribunal's are effectively left to their own devices in their decision-making. As the various sub-section below indicate, arbitral tribunals in their application of discretion can take widely diverging positions on issues regarding the choice and application of valuation methods.

7.1 Bases of Value

The choice of any valuation method must begin with the question of what constitutes value. The term 'value' itself does not yield to an objective understanding; its meaning may vary based on the person who is inquiring into its meaning. The International Valuation Standards (IVS) as adopted by the International Valuation Standards Council defines basis of value as a 'statement of the fundamental measurement assumptions of a valuation'[150]. It encapsulates the purpose for which valuation is being carried out and helps determine the appropriate valuation method that may be applied. Some factors that may define the bases of value include statutes, regulations, contracts etc. The 'basis of value' in legal disputes is generally derived from the legal standard of compensation or damages that is provided by the applicable law. Therefore, the international legal standards that were discussed in the previous sections apply in the form of valuation bases during the calculation process. Lawyers typically instruct their clients' damages experts

The IVS recognises several bases of value, including market value, market rent, investment value, equitable value, fair market value, liquidation value and replacement value, among others[151]. The selection of a basis of value helps in the determination of questions such as 'value to whom?' and 'under what circumstances', as already seen with the distinction between subjective-objective valuation criteria earlier. While fair market value of an asset indicates its

[149] Florin A. Dorobantu, Natasha Dupont and M. Alexis Maniatis, 'Country Risk and Damages in Investment Arbitration' (2016) 31 ICSID Review 1219
[150] Section 10.1, International Valuation Standards 104: Bases of Value
[151] Ibid Section 20.1

value in exchange in a hypothetical sale between a willing buyer and willing seller, the 'full-reparation' standard applies a basis of *value to the holder* of the asset[152].

It has been earlier noted that lawful expropriation of property attracts the fair market value-based compensation as the applicable standard under most treaties. On the other hand, acts in breach of international law (or internationally unlawful acts) are compensated under the subjective standard of full reparation. This is also the standard followed for breach of investment contracts, although the term 'full compensation' may be used instead of 'full reparation' in such cases. Despite these differences, it bears repetition that tribunals on many occasions have calculated damages on objective basis like fair market value, even though the applicable compensation standard was full reparation. In case where parties claim that the loss arising from an unlawful act is equivalent to the fair market value of the investment, tribunals have proceeded with calculating the fair market value accordingly. Claimants may also seek compensation additional costs along with the fair market value of the investment, such as moral damages, which must be accounted for separately. However, compensation for lawful expropriation cannot be calculated using a subjective basis, as the amount of compensation in such cases are limited by investment treaties to the fair market value of the property or asset. Any additional compensation would amount to undue enrichment of the claimant-investor and must therefore be avoided.

Fair market value is among the most commonly used basis of valuation for general financial assessments as well as in the context of investment adjudication. The IVS refers to it as 'market value', with the following definition –

> Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion[153].

Applying this understanding to the investment arbitration context, the fair market value of the investment that is the subject of the dispute must be considered immediately prior to the act of expropriation and in terms of the price that a hypothetical willing buyer would have paid to a willing seller. The knowledge of an impending expropriation or other such factors would not be included as the purpose of the assessment is to identify the value of the asset in an open and a competitive market. Expropriation clauses also ensure this by specifically excluding

[152] Marboe (n 3) para 4.35
[153] Section 30.1, International Valuation Standards 104: Bases of Value

knowledge of expropriation from the assessment of fair market value. For example, Article 9.8.2 of the CPTPP states that compensation for expropriation shall "not reflect any change in value occurring because the intended expropriation had become known earlier"[154]. Aside from objective criteria, subjective bases of valuation may also be necessary. One such basis, known as 'investment value', is aimed towards ascertaining the value of an investment in its particular relationship with the owner. IVS defines the investment value basis as the value of an asset to a particular owner or prospective owner for individual investment or operational objectives[155].

Using investment value as the valuation basis necessitates evaluation from the perspective of the investment owner and the value that is being derived. Even if the market value of the same investment or asset may be zero, the owner may derive unique benefits from the asset, which would have to be valued accordingly. For example, an obsolete piece of machinery may have zero or near zero value for the market due to the lack of any utility but may be useful to its owner for conducting specific tasks. Similarly, a piece of software may have no utility for anyone else other than its owner due to a function that it performs. Such assets may hold value that is unique to the asset owner in question. Therefore, if an unlawful state act impairs the value of the investment, then the damages payable to the owner will be in terms of its specific value to the owner and not the market value. As a subjective standard, the investment value basis is suited for calculating damages for breach of international law or contracts. By comparing investment value in a but-for and actual scenario, it would be possible to account for the loss of value and the damages that would arise consequently. Factors such as costs incurred by the owner in acquiring and developing the investment would be an important factor in such calculations. Similar approaches are also applied when using other subjective basis of valuation, such as contract value.

Although the calculation of compensation and damages differ in terms of the basis of valuation used (objective v. subjective), many arbitral tribunals and disputing parties have elected for fair market value-based assessments in damages cases. Even for damages arising from non-expropriatory breach of international law, arbitral tribunals have used the fair market value basis to assess the but-for scenario and thereby calculate the diminution of value of the investment along with additional damages, where necessary[156]. In cases where breach of international law has led to permanent loss of investment akin to expropriation, damages have

[154] Article 9.8.2, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (signed 8 March 2018, entered into force 30 December 2018)
[155] Section 40.1, International Valuation Standards 104: Bases of Value
[156] Ripinsky and Williams (n 3) 182

been evaluated on a fair market value basis in a manner identical to lawful expropriation cases[157]. Therefore, most of the commonly used valuation methods by tribunals are those that enable the calculation of fair market value of an asset or investment. Various adjustments are then applied to the amounts obtained in order to ensure that the full reparation standard for damages is fulfilled.

7.2 Valuation Approaches

The various methods of valuation used in assessment of compensation and damages are categorised under three approaches: market-based, asset-based and income-based[158]. The three approaches evaluate different aspects of a business in order to identify their market value. It should be noted that tribunals are not bound to apply a certain approach exclusively. In most cases, parties submitted investment valuations using different methods that are evaluated by tribunals in order to identify the most suitable approach[159]. Often, different valuation methods may be used in combination in order to ensure that all relevant factors in valuation have been duly considered. Rather than a universal rule or principle of law, the tribunal's analysis at this stage is guided by the facts of the case, the assets involved, and the manner of loss suffered by the claimant. Therefore, comparisons between different arbitral awards may not always provide an accurate picture of the convergence or divergence in the approach of arbitral tribunals regarding the choice of valuation applied and the discretion exercised therein. As the different approaches to valuation have already been examined in detail by a number of arbitration scholars[160], the valuation approaches are described below only in brief. Instead, a more detailed examination is provided regarding the various issues that affect the application of some of the most frequently used valuation methods, such as discounted cash flow.

[157] Thomas W. Wälde and Borzu Sabahi, 'Compensation, Damages, and Valuation' in Peter Muchlinski, Federico Ortino, and Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) at 1082
[158] Kantor (n 147) 8
[159] Ibid 27
[160] Valuation approaches have been examined in detail in Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (Oxford University Press 2017) 4.73; Sergey Ripisnky and Kevin Williams, *Damages in International Investment Law* (BIICL 2008) 183; Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (Wolters Kluwer 2008) 9; Thomas W. Wälde and Borzu Sabahi, Compensation, Damages, and Valuation, in Peter Muchlinski, Federico Ortino, and Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) at 1070

7.2.1 Market-based Approach

The market-based or sales comparison approach relies on a comparison of the value of the investment with similar assets or market transactions involving similar assets in order to obtain an indication of the investment's own value. This method uses the available price information of a similar asset in order to estimate the subject investment's value, often using a value multiple for adjustment[161]. The principal assumption behind this approach lies in the notion that similar assets trade in the market at similar prices, though certain adjustments may be made for risks and special costs involved. Therefore, for assets that are frequently transacted in market, the market-based approach may provide the best indication of value. If the subject investment is a listed entity in the stock market, then stock prices tend to be the simplest indicators of value[162]. For example, in the case of expropriation of a listed entity, its share price prior to the expropriation multiplied by the outstanding shares provides an indicator of the market value, although several adjustments may have to be considered. For unlisted entities, one would have to look at comparable transactions of similar businesses, or even prior transactions involving parts of the subject investment as indicators of value. Thus, the presence of a market for the investment, frequent or recent observable transactions for similar assets in the market, or a history of prior transactions constitute some of the necessary factors supporting a market-based approach to valuation[163].

The two valuation methods that are commonly applied under market-based approaches are the *comparable transactions method* and the *market multiples method*. As already noted, the comparable transactions method attempts to value an asset through comparison of similar assets in visible market transactions. For a fair assessment, the comparable transaction should be an arm's length transaction involving an interested buyer and seller. Such comparable value, when extrapolated ideally from a large number of transactions provides a reliable estimate of how the market values an asset. As Kantor notes, the best evidence of fair market value may be the price agreed between transacting parties in an arm's length transaction, where each party is knowledgeable of the relevant facts[164]. This was the position taken by the UNCITRAL Tribunal in *CME v. Czech Republic*, wherein it referred to similar positions taken by the IUSCT while observing that "one of the best possible indicators of an enterprise's fair market value is what

[161] David Saunders and Joe Skilton, 'The Applicable Valuation Approach' in John A Trenor, *Global Arbitration Review Guide to Damages in International Arbitration,* (Law Business Research Ltd. 3rd ed. 2018)
[162] Marboe (n 3) 4.82
[163] Section 20.2, International Valuation Standards
[164] Kantor (n 147) 19

an actual willing buyer thinks it is worth."[165] In the case of *Enron v. Argentina*, the evidence of transactions regarding the investment in dispute have been used to ascertain market value instead of the estimated value reached using a DCF valuation[166].

The other method of valuation under this approach is of market multiples, the value of the subject investment is derived from prices of comparable assets using commonly standardized financial variables[167]. A multiple represents a financial ratio, such as price-to-earnings, price-to book, EBITDA (earnings before interest, tax, depreciation and amortization) which is derived from a similar asset in the market. For example, the price-to-earnings ratio or P/E ratio (share price divided by earnings per share) is a commonly used financial indicator used for publicly listed companies. Assuming that a comparable company with a share price of USD 100 and earnings per share of USD 20, its P/E ratio will be 5. The target company has reported earnings per share of USD 5, but the fair market value of its shares are unknown or disputed. Assuming both companies to be substantially similar, the comparable P/E multiple of 5 can then be applied to obtain a fair market value of the target company's share at USD 25 per share (earnings per share multiplied by the P/E multiplier). Similarly, market-level P/E ratios of entire industries, such as automobiles, or oil and gas sector, are also available for comparison. The multiplier method can thus be used to fill gaps and achieve comparable valuations of companies and their assets.

The limitation of the market-based approaches become apparent where the subject investment is of a heterogenous nature. For example, long term infrastructure projects undergoing several years of operation may not yield easily to market-based approaches, particularly in sectors where similar projects are relatively rare. Nuclear power projects, rare earths metals mining, offshore resource exploration etc. are such sectors where the market size may not be as broad enough or may not have frequent transactions to allow for a comparable assessments. Manufacturing projects producing highly differentiated goods may also face a similar problem, particularly in young industries. Additionally, investments themselves may have distinct characteristics that may not yield to side-by-side comparison with other similar assets. For example, projects may be at different stages of their life cycles or have distinct variables of input and labour costs due to their location, which would have to be accounted for before any

[165] *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL Final Award (14 March 2003) para 140
[166] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3 Award (22 May 2007) para 338
[167] Ripinsky and Williams (n 3) 213

fair comparison is possible[168]. Even though the investment as a whole may not be comparable, parts of the investment or such as its constituent assets may be valued using the market-approach for obtaining a fair market value. Market approaches can also be used in conjunction with other approaches or to verify the values obtained in other approaches. The IVS Guidelines state in this regard:

> The heterogeneous nature of many assets means that it is often not possible to find market evidence of transactions involving identical or similar assets. Even in circumstances where the market approach is not used, the use of market-based inputs should be maximised in the application of other approaches[169].

The risk of market volatility is also an important factor for consideration in the application of market of value. Where investment projects are engaged in the extraction or production of certain commodities, short-term variations in the commodity price can affect the value of the business immensely. A recent example of such unpredictable volatility was the crude oil price crash in March-April 2020 that accompanied the onset of the COVID-19 pandemic globally[170]. Consequently, the market value of some of the biggest oil and gas companies fell drastically, with crude oil holdings being their primary assets. Therefore, it has been suggested that market approaches at single points of time may not provide an accurate picture of the investment value, and a longer period of time should be considered[171]. Naturally, the role of the arbitral tribunal is crucial at this stage, as the tribunal decides on whether and how a particular method is applied to obtain fair market value.

In investment disputes, the market-based approach has been sparingly used by tribunals. In most cases, tribunals have elected to use market-based approaches in order to verify the valuations obtained with other methods. The principal issue that often arises here is the lack of a comparable market or established prior transactions for many of the investment projects in dispute. This could be due to many reasons, including the early stage of investment, lack of competitors or comparable firms in the same market, uniqueness of the goods or services being produced, among others. In some cases, tribunals have accepted the actual transaction value as a method for valuation of damages, but subsequently rejected the amount claimed as fair market

[168] Saunders and Skilton, (n 161) 206-207
[169] Section 20.4, International Valuation Standards
[170] Jillian Ambrose, 'Oil prices dip below zero as producers forced to pay to dispose of excess', *The Guardian* (20 April 2020) <https://www.theguardian.com/world/2020/apr/20/oil-prices-sink-to-20-year-low-as-un-sounds-alarm-on-to-covid-19-relief-fund>
[171] Wälde and Sabahi (n 157) 1073

value using such method. In *Azurix Corporation v.* Argentina[172], the arbitral tribunal accepted the market transaction value offered by the claimant as the valuation method for damages. However, the tribunal found that cost of acquisition of the disputed concession incurred by the claimant-investor, amounting to over USD 438.55 million, could not be considered as the fair market value of the concession. The tribunal reasoned that all other bidders for the concession had placed significantly lower bids for the concession and that no reasonable investor being aware of the terms and the factual scenario during the bidding process would have reasonably bid the amount that was offered by the claimant investor. Therefore, the fair market value could not be the amount actually paid by the investor, but a much lower value of USD 60 million[173].

The market-based approach shares many characteristics to the income-based approach, examined in the next section. Crucially, both approaches are forward-looking, and consequently may not account for historical performance or sunk costs involved in the investment. These limitations are often extensively considered by tribunals before adopting a choice of valuation.

7.2.2 Income-based Approach

One of the most enduring principles of valuation is that the value of any business or asset is reflected by its ability to generate profits for its owner[174]. The income-based approach to valuation relies on this principle to estimate the value of an investment by calculating the present value of its anticipated benefits. The IVS Guidelines define income approach as follows:

> The income approach provides an indication of value by converting future cash flow to a single current value. Under the income approach, the value of an asset is determined by reference to the value of income, cash flow or cost savings generated by the asset[175].

Instead of relying on an external indicator as with the market-based approach, the income-based approach derives value based on a forward-looking view of income that may accrue from an investment over its lifetime. As the IVS Guidelines indicate, income-based approaches are particularly advantageous in case where the income producing ability of assets are the critical elements affecting value and there are limited or no relevant market comparables[176]. Therefore, where investments constitute unique and complex combinations of assets with an ability to

[172] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12 Award (14 July 2006)
[173] Ibid para 429.
[174] Tim Koller, Marc Goedhart and David Wessels, *Valuation*, 6th ed. (McKinsey and Company 2015) 120
[175] Section 40.1, International Valuation Standards
[176] Ibid, Section 40.2

generate long term cash flows, the income-based approach is particularly suitable. The increasing use of such approaches in investor-state disputes may thus be explained on these grounds, considering that the investments in dispute often correspond to such complex, long-term projects. In 2020, ICSID reported that over 50% of its new cases in the fiscal year were related to investments in the oil, gas and mining industries along with electric power and construction projects[177]. This has been a consistent trend over many years, with large scale infrastructure, mining, energy and construction cases dominating investment arbitration caseloads. Due to the high degree of differentiation and the varied life-cycles involved, such investments are often difficult to compare and value using market-based approaches. These considerations have proven to be important in the increasing acceptance of income-based approaches to valuation in investor-state disputes.

There are various methods of valuation with income-based approaches, namely (i) the discounted cash flow method (ii) income capitalization method and (iii) option pricing models[178]. The discounted cash flow (DCF) method is by far the most commonly used method of valuation not only among income approaches, but also increasingly for valuation of compensation and damages in general[179]. Therefore, this section on income-based approaches will be limited to examining the DCF method and its application.

Before moving the discussion towards DCF, it is interesting to note how income-based approaches have emerged as the preferred means of estimating fair market value in investment disputes. The Iran-United States Claims Tribunal and some of the early ICSID tribunals were largely sceptical of forward-looking, income-based approaches to valuation. Many tribunals noted the speculation inherent in estimating future income or cash flows, particularly in the case of assets with little or no performance record or earnings history. This has earlier been noted with reference to the rejection of the claimant's calculations on damages in *SPP (Middle East) v. Egypt* and *Wena Hotels v. Egypt.* The ICSID Tribunal in *Aguas v. Argentina* reiterated the position of taken by many prior tribunals while stating that use of DCF method to calculate net present value becomes less appropriate as more assumptions and speculative projections get involved[180].

[177] ICSID, 'The ICSID Caseload – Statistics'(23 August 2020) at 25
[178] Marboe (n 3) para 4.90
[179] Leonardo Giacchino and Thomas Sturma, 'Trends in Awards from Concluded ICSID Cases' (2017) 42 Journal of Damages in International Arbitration 2
[180] *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3 Award (20 August 2007) para 8.3.3

As a broad survey of ICSID awards until 2017 by Giacchino and Sturma indicates, most arbitral awards in the 1980s and 1990s contained asset-based approaches to the calculation of damages by tribunals[181]. However, in the 2000s, income-based approaches began to find increased favour as the preferred method for valuation. Presently, income-based approaches are most commonly applied by arbitral tribunals, followed by asset-based approaches. Claimants have increasingly begun to adopt income-based approaches in their submissions. While this could be due to a variety of reasons, including the specific facts in issue, commentators have noted how a higher average rate of recovery (42.5%) than asset-based approaches (34.3%) could possibly be a reason[182]. Further, increased familiarity with income-based methods over the years, arbitrators are also less likely to reject methods like DCF outright. Parties may therefore have more confidence in using these methods than a few decades ago.

A. Applying the DCF Method

The application of the DCF method involves discounting future cash flow estimates into a singular net present value of an investment, whether it is an entire business or an asset. The rationale governing DCF - the value of an investment is reflected by its capacity to generate cash flows – is easily understood in its application. However, the considerable speculation inherent in such estimates of future earnings of a business has proved to be the principal cause of concern for arbitral tribunals tasked with awarding damages on such basis. The uncertainties and estimates involved places significant substantive discretion with arbitrators on a number of questions. Firstly, where disputing parties submit different valuation methodologies including DCF, tribunals may weigh the suitability of each method against the other and decide on an appropriate method. Secondly, after a method has been selected, tribunals continue to exercise discretion in making adjustments to the calculations provided, if necessary. These adjustments may be incorporated directly into the mathematical formula, or as broader adjustments to the finalised fair market value of the investment.

To understand the operation and the discretion involved in the DCF method, it is necessary to examine its mechanism. The first component of any DCF model is the estimate of cash flows that are generated by the investment. Cash flow refers to the cash generated over a period of time by an asset, and which generally takes various forms[183]. These cash flows may be adjusted

[181] Giacchino and Sturma (n 179) 75
[182] Ibid 81
[183] Section 50.5, International Valuation Standards

for inflation (real v. nominal cash flows), accruing to the shareholders or the firm (free cash flow to equity v. free cash flow to firm) or adjusted for tax (pre-tax or post-tax). Regardless of the type of cash flow applied, it is necessary that other factors used in the DCF are adjusted accordingly[184]. Even though DCF is concerned with future cash flows, the effects of historical or current information will be visible, such as the nature of the investment, prior cash flows , management etc. The second crucial element to the DCF is the factor by which these future cash flows will be *discounted* in order to obtain their current value. The reason for discounting future cash flows is based on the theory of time value of money – the value of a dollar today is worth more than its value tomorrow or next year[185]. This is because a hypothetical investor can immediately invest the dollar received today to obtain a return on the dollar, making it worth more than the same dollar at a future date. Therefore, for an investor to consider making an investment, the future returns on such investment must exceed the return obtainable immediately. Consequently, a discount factor helps to calculate the present value of a cash flow or return on investment that is expected in the future. Since the purpose of the DCF is find the present value of all future cash flows generated by an investment, these cash flows are accordingly adjusted using the discount factor. The formula for DCF is described as follows:

$$\text{Present value} = \frac{CF_1}{(1+d)} + \frac{CF_2}{(1+d)^2} + \ldots + \frac{CF_n}{(1+d)^n}$$

Where:
CF = cash flow projected for the year/period of operations
n = number of years/periods
d = discount rate

As indicated, the cash flows accruing each year from the investment are discounted by a discount rate, *d* and added together to obtain the present value. The DCF model is driven by these dual considerations of cash flow and discount rate estimates, and often becomes the subject of lengthy contestation between disputing parties. A discount factor increases exponentially with the distance of time, and therefore even a marginally larger discount factor can reduce the present value of an investment drastically. For example, a hypothetical investment is estimated to generate USD 100 in cash flow after one year, followed by an additional USD 10 per year over four years. The present value of these cash flows are estimated

[184] Marboe (n 3) para 4.93
[185] Schumacher and Klönne (n 141) 208

using two different discount rates of 5% and 7%. The resulting cash flows from each discounted period would be as follows –

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total Present Value**
Cash Flows	100	110	120	130	140	
Present Value at 5% discount rate	95.25	99.8	103.7	107	109.7	515.45
Present Value at 7% discount rate	93.5	96.1	98	99.2	99.8	486.6

Thus, an investment generating USD 600 in total cash flows over 5 years provides these two present values of USD 515.45 and USD 486.6 at different discount rates. From this simple calculation using the DCF formula, it is seen that a difference of only 2% in discount rate leads to a significant difference in present value of the investment. Here, the present value of an investment of USD 515.45 calculated at 5% discount reduces by almost 6% when a slightly higher discount rate is applied. Larger differences in discount rate would consequently yield even larger amounts in difference of present value.

While this illustration serves as a simplified example of the importance of the discount factor in the DCF model, it must be understood that the actual determination of discount rates can be a complex process. Similarly, future cash flows of a business cannot be reliably estimated without adequate information data, indicators or historical information regarding the business, which is particularly the case with new enterprises with little or no operational record. While information from comparable businesses may be taken by applying a market-based approach to estimate the probable future cash flows, the degree of speculation involved may affect the decision-making of the arbitral tribunal. In investor-state disputes, the disputing parties often achieve diverging results while applying the DCF method, primarily due to difference in inputs that are provided for the estimates[186]. Ripinsky and Williams have suggested that the major disadvantage of this method lies in the wide scope of variations in calculating the inputs involved in the DCF model, including the assumptions of sales, costs, capital requirements, risk levels, future conditions, currency fluctuations etc. In considering all of these factors, the tribunal must weigh the likelihood and veracity of each element incorporated by the parties

[186] Ripinsky and Williams (n 3) 201

based on their best-informed estimation. An assessment of the elements involved in the discount rate in itself may serve as a good example.

The discount rate reflects the time value of money as well as the *risks* associated with a business under realistic circumstances[187]. The cash flows arising from any business for each period of time measured are not divorced from the risks involved, and the act of discounting reflects the consideration of such risks arising in the course of business. Such risks include systematic risks, which are inherent to and effect the overall market in which a business operates, or unsystematic risks, which include risks associated with the particular business in question. These are also frequently referred to as market and specific risks, respectively. Various approaches are available to account for such risks that are used to calculate the discount rates applied in the DCF model, two of the most widely used being (i) the 'build-up' procedure[188] and (ii) Weighted Average Cost of Capital (or WACC) approach[189]. The principal difference between these approaches lies in the manner in which the final discount rate is computed.

The build-up approach combines the elements of systematic and unsystematic risk to a "risk-free rate" – a rate of return that is expected from an investment carrying hypothetically zero-risk[190]. The risk-free and systematic rates constitute the 'base' discount rate that constitute the objective and verifiable components of the discount rate, as they are derived from the overall market in which an investment operates[191]. The unsystematic risk component comprises a wide variety of factors like market and financial risk, management risk, product risk etc.

While considering systematic risks, controversy generally arises in assigning the appropriate discount that adequately accounts for the risks involved, also referred to as the 'equity risk' component. As Kantor explains, the equity risk component accounts for the greater market risk and volatility associated with holding an equity investment rather than debt (such as Treasury bonds)[192]. Consequently, any investor will expect a higher return from owning an equity position in an investment that must be incorporated in the eventual discount rate. This is referred to as the equity risk premium that must be quantified and added to the base discount rate. The equity risk premium would vary on the basis of a number of factors, including the country where investment has been made, the duration of the investment and its resulting cash flows,

[187] Richard Brealey, Stewart Myers and Franklin Allen, *Principles of Corporate Finance*, (McGraw Hill 12th ed 2018) at 32
[188] Kantor (n 147) 143
[189] Ibid 233
[190] Brealey, Myers and Allen (n 188) 551. Examples of such-zero risk investments include US Treasury Bills.
[191] Kantor (n 147) 144
[192] Ibid 146

variations in historical returns etc. all of which have to be examined by the arbitral tribunal while considering the discount rate.

In the case of unsystematic risks, i.e. specific risks of the investment, there is frequent contestation regarding the manner in which specific risks to the investment may be assessed. While it is one thing to account for market risks affecting a change in government policy, individual company-level risks from the same policy may not be as straightforward, particularly where such risks are indirect. Claimants to damages usually seek a lower discount rate by arguing that the subjective risks to the investment are already incorporated into the revenue and costs estimates that go into the cash flow projections[193]. Such estimates therefore require to be thoroughly examined by tribunals in order to avoid instances of double counting.

The WACC model takes a different approach to the determination of the discount rate. Instead of using a building-up process, the WACC-based approach estimates the future cost to the company of borrowing new debt and for obtaining new equity capital. The cost of the debt and equity capital are weighed on the basis of a debt-to-equity ratio in order the obtain the WACC rate. According to Kantor, the rationale behind using WACC lies in the consideration that a proper discount rate should balance between risks and benefits that arm's length third-party investors and lenders would reach if they made new loans and new equity investments to the company at the valuation date[194].The WACC applies as a reliable indicator of the opportunity cost incurred for an investor in a company at the same level of risk.

The WACC model avoids the subjective assessments of risk inherent in the build-up model by relying on market indicators. For companies with outstanding equity and debt securities, the assessor can calculate the likely costs associated with issuing new debt or raising capital. This is akin to market-based approached to valuation, in terms of the comparative basis used for calculation. Consequently, WACC estimates also suffer from similar problems as marker-based approaches where the subject investment is not a publicly traded company or where it is operating in a market that lacks adequate comparables.

Considering the sensitivity of the valuation to the discount rate as well as future cash flow estimates, it is quite understandable that many arbitral tribunals approached DCF method quite cautiously, with significant verification of the investment values done by using other valuation

[193] Ibid 156
[194] Ibid 160

approaches. Some of the positions taken by past tribunals are particularly useful for examining how tribunals have dealt with uncertainties and speculative elements present in this method.

B. Tribunal Approaches to DCF valuations

Arbitral tribunals increasingly began to favour income-based approaches to valuation in the 2000s, a marked shift from prior decades when tribunals largely expressed scepticism regarding forward-looking methods like DCF. During the 1980s and early 1990s, other than a few notable cases like *Starett Housing v. Iran*[195] and *Amco v. Indonesia*[196], DCF-based valuation was rarely applied in investor-state disputes, with asset-based valuation being the most commonly used method. Over time, the principal grounds for rejection of DCF-based assessments as held by arbitral tribunals were as follows -

(i) lack of sufficiently long performance record[197]

(ii) failure to establish future profitability[198]

(iii) lack of sufficient finances to complete and operate the investment project[199]

(iv) large disparities between the amount invested and the fair market value claimed[200]

In addition to these grounds, Marboe cites additional factors such as divergence in submissions by disputing parties and financial situation of the invested company as grounds for rejection by arbitral tribunals[201]. Arbitrators have shown particularly highlighted the uncertainties of future streams of revenue as the core drawback with income-based approaches, as stated in some well-

[195] *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others* IUSCT Case No. 24 Final Award (Award No. 314-24-1) *Asian Agricultural Products Ltd. v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3 Final Award (27 June 1990)
[196] *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1
[197] *American International Group, Inc. and American Life Insurance Company v. Islamic Republic of Iran and Central Insurance of Iran (Bimeh Markazi Iran)* 1983 IUSCT Case No. 2 (Award No. 93-2-3);
[198] *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17 Award (21 June 2011); *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/26 Award (29 January 2016)
[199] *Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v. The Government of Mongolia*, UNCITRAL Award (2 March 2015)
[200] *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (3 December 2000) at para 77, 41 ILM 896 (2002)
[201] Marboe (n 3) para 5.205-5.209

known awards like *Amoco International Finance Corporation v. Iran*[202], *Metaclad v. Mexico*[203] and *Vivendi v. Argentina*[204]. As Ripinsky and Williams note, the discomfort of arbitrators with valuation methods like DCF stemmed from the apparent contradictions between the legal requirement that speculative, uncertain and indeterminate damages cannot be awarded and the inherently speculative nature of DCF-related estimates[205]. At the same time, where the applicable legal standard for compensation or damages is fair market value, tribunals cannot ignore the fact that DCF is one of the most widely used and accepted methods for calculating fair market value for wide range of businesses and assets at different life cycles. As the investor-state dispute settlement system continues to mature, arbitral practice has moved towards greater alignment with market-oriented approaches to valuation. Therefore, it is no wonder that the application of DCF models have increased over time.

Arbitrators have sought to balance the tensions between uncertainty and speculation on hand and the larger consensus on DCF for accurate fair market value estimates by taking a discretionary approach. This has meant that tribunals have resorted to informed estimation in deciding (i) whether to apply DCF in a particular case, and (ii) the adjustments to be made in the input values (cash flows, discount rates) based on the best available information available. Therefore, such assessments have largely been driven by factual analysis on a case-by-case basis along with reference to prior arbitral practice. The Tribunal in *Crystallex v. Venezuela* observed that there is no methodology that can be considered to be best suited in determining the fair market value of an investment in all situations. Tribunals can adopt techniques and methods that are accepted in the financial community. The selection of the most appropriate method is on the basis of the circumstances of a given case, given that value is more of a statement of opinion rather than a finding of fact[206].

Although arbitral tribunals largely agree on broader principles such as the avoidance of largely speculative damages, the decision regarding whether certain inputs are speculative are largely based on the tribunal's discretion. For instance, certain tribunals have accepted DCF-based valuations even in the absence of a sufficiently long performance record of an investment.

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[202] *Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran, National Iranian Oil Company, National Petrochemical Company and Kharg Chemical Company Limited*, (1987) IUSCT Case No. 56 Partial Award (Award No. 310-56-3)

[203] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000)

[204] *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3 Award (20 August 2007)

[205] Ripinsky and Williams (n 3) 211

[206] *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award (4 April 2016)

Particularly in the case of mining investments, even though such mines never came into operation, arbitral tribunals have accepted DCF valuations done on the basis of available information regarding the value of mineral deposits prior to expropriation or commission of an unlawful act by the host State. This was the rationale applied by the arbitral tribunal in *Gold Reserve v. Venezuela*[207] and more recently in *Tethyan Copper Company v. Pakistan*[208]. In the latter case, the Tribunal examined the arbitral reasoning applied in *Gold Reserve* and other related cases in order to eventually develop a two-step test to determine whether the DCF method was applicable for an investment with no track record.

> The first key question is whether, based on the evidence before it, the Tribunal is convinced that in the absence of Respondent's breaches, the project would have become operational and would also have become profitable. The second key question is whether the Tribunal is convinced that it can, with reasonable confidence, determine the amount of these profits based on the inputs provided by the Parties' experts for this calculation[209]. (emphasis added)

On this basis, the Tribunal held that if there are no 'fundamental uncertainties' due to which the investment would not enter into operation, then the DCF method may be applied. This decision is to be made by the arbitral tribunal based on its assessment of the facts and evidence, thereby leaving it largely to the discretion of the tribunal. Similarly, other grounds for rejection of DCF have been subject to the discretion of tribunals.

If the application of valuation methods like DCF is entirely subject to fact-based discretion, a question then arises is whether arbitral tribunals can make 'wrong' choices of valuation method, and if so, how such decisions can be remedied? It is quite apparent that where limited market or financial information regarding an investment is available, some valuation methods are clearly more suited than others. For instance, a publicly traded asset with robust comparables will almost always be valued on a market-based approach based on the notion that fair market value is most reliably determined by what third parties are willing to pay for the asset in an arm's length transaction. Valuing such an asset on an income-based approach will not *per se* be wrongful but may lead to an incorrect valuation. Consequently, an act of valuation that does either falls short of or exceeds applicable legal standard can lead to either of the two situations – under-compensation or over-compensation. Anything other than fair market value for expropriation and full reparation for damages would lead to unjust enrichment of one party at

[207] *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award (22 September 2014)
[208] *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, ICSID Case No. ARB/12/1 Award (12 July 2019)
[209] Ibid para 330

the expense of the other[210]. Considering that the choice of valuation method can have a significant effect on the investment value, the tribunal's discretion in applying a valuation method or a combination of methods must not violate the applicable legal standard for compensation or damages. Yet, as we will see in the next chapter, there are no effective means in investor-state arbitration by which violations of this sort can be remedied. Therefore, in applying valuation methods with particularly input-sensitive mathematical models, arbitral tribunals may verify the reasonableness of the inputs used, as well as cross-check the calculations and the results with other valuation methods in order to ensure that the best approximation of the applicable valuation standard is reached. In the particular case of DCF valuation, the tribunal in *Rusoro Mining v. Venezuela* stated quite appropriately that DCF is not a "friar's balm" which can cure all ailments. It is one among many financial techniques enabling an expert to estimate the value of an investment in terms of its fair market value. However, small adjustments often tend to lead to significantly diverging results and must therefore be subject to a "sanity check" against other valuation methods[211].

7.2.3 Asset-based Approach

The asset-based approach to valuation differs significantly from the two previous approaches in terms of how it seeks to assess value. Instead of applying forward-looking estimates, asset-based methods take a backward approach in summing up the values of individual assets that constitute the investment. The advantage of using an asset-based approach lies in the avoidance of making estimates regarding future revenue streams. Instead, it focuses on historical costs and an account of value of existing assets and is therefore also referred to as the *cost-based* or *cost approach*. In investor-state arbitration, the use of valuation methods under the asset-based approach have been quite popular for this reason[212]. The IVS Guidelines describe asset or cost-based approach in the following manner –

> The cost approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction, unless undue time, inconvenience, risk or other factors are involved[213].

[210] Marboe (n 3) para 2.63
[211] *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5 Award (22 August 2016) para 760
[212] Marboe (n 3) para 5.216
[213] Section 60.1, International Valuation Standards

In fact, most investor-state tribunals until the 2000s relied primarily on asset-based approaches to calculate fair market value and award compensation and damages accordingly[214]. Asset-based methods also had the advantage of using information that was already in the company's books instead of ex-post estimates of value that was derived by third parties, such as experts. Explaining the particular advantages of asset-based methods in terms of the information used, Wälde and Sabahi noted that it is the most objective method available to the tribunal. This is because the asset-based approach is based on tangible costs involved with purchasing assets, instead of forward-looking approaches that have a distinctive element of speculation involved[215].

However, the downsides of the asset-based approach can also be significant. First of all, the asset-based approach provides the value of the historical cost of an asset, i.e. the cost of acquiring an asset. These values as such may not reflect the fair market value on the date of expropriation or of the award, whichever is chosen to be the valuation date. Secondly, the approach adopts an analogy where the value of the company or enterprise is considered to be the sum of its assets. However, many companies are considered to be far more valuable by the market than the assets they own due to varied factors such as goodwill, intangible assets, sector-specific advantages etc. These factors may not be reliably reflected in asset-based valuations and result in a lower valuation than the actual fair market value[216]. Therefore, some commentators state that asset-based methods are less reliable than income or market-based approaches to valuation when used to obtain the fair market value entire companies or businesses[217]. However, such methods may be suited in situations to establish the 'floor price' of such businesses, particularly where the business stops being a going concern, or its assets are non-operational. In many cases, asset-based approaches are more suited to valuing individual assets rather than an enterprise as a whole. Thus, such methods can be used to supplement other valuation methods, particularly where a business involves sizeable assets.

The rest of this section will briefly examine the principal valuation methods used under the asset-based approach. The three methods of valuation under the asset-based approach that are commonly recognised are (i) book value (ii) replacement value and (iii) liquidation value.

[214] Giacchino and Sturma (n 179) 81
[215] Wälde and Sabahi (n 157) at 1072
[216] Mark Bezant and David Rogers, Asset-Based Approach and Other Valuation Methodologies, in John A Trenor, *Global Arbitration Review Guide to Damages in International Arbitration* (Law Business Research Ltd. 3rd ed 2018)
[217] Ripinsky and Williams (n 3) 219

A. Book Value

The book value method seeks to calculate the 'book value' of a company on the basis of its balance sheet. The value of the company is determined by the value at which the tangible assets of the company appear on the balance sheet, after deducting for the accumulated depreciation in their value according to the applicable accounting principles. The net book value of an investment is the difference between the enterprise's assets and liabilities as reflected in the financial statements of the company[218]. The book value of a company is primarily an accounting concept that aims to indicate the historical cost value of an asset whose value keeps getting adjusted over time due to the loss of value over time. The book value is therefore not a good indicator of market value, as it does not take into consideration market forces or other external factors that may affect asset prices positively or negatively.

The value of an asset over a span of time may no longer be reflect its fair market value, because of which book value is hardly a good tool for valuation by arbitral tribunals. The World Bank Guidelines on Treatment of Foreign Investment note that book value may closely represent fair market value only when valuation is done for recently purchased assets where such assets may more closely resemble the market value at which they were obtained[219]. Therefore, the Guidelines do not recommend the use of book value where an enterprise is a going concern and can therefore be valued using other parameters like income or market multiples. Arbitral tribunals have also refused to apply the book value when several years have elapsed after an investment has been made[220].

Arbitral tribunals have more commonly used a modified book value method, known as *adjusted* book value (ABV) for valuation of compensation and damages. While starting with the same approach as book value in terms of calculating the difference of value between the assets and liabilities of a company, ABV also incorporates the value of material assets and liabilities not found in the accounting balance sheet and adjusts them to reflect their fair market value[221]. ABV is most commonly used in valuing asset-intensive companies where such assets are largely tangible and can be sold easily. For example, enterprises operating in petroleum and

[218] Ripinsky and Williams (n 3) 221
[219] World Bank Group (n 40)
[220] *The Government of the State of Kuwait v. American Independent Oil Company*, Award (24 March 1982)
[221] Kantor (n 147) 231

natural gas, shipping or hotels usually maintain a large stock of assets from which they derive their revenue.

Although ABV is perceived to be a more accurate representation of fair market value of assets, it must be noted that the adjustments that have to be made in the process are often complex in nature and carry the potential of drastically altering asset values. Particularly where ABV is applied to adjust values of off-balance sheet assets and liabilities, the basis for such adjustments may not be as clear or apparent. The Lawyer's Business Valuation Handbook cites some of these off-balance assets and liabilities as including goodwill, intellectual property developed internally, assets fully depreciated in the accounts but that still provide a useful service, environmental liabilities, other contingent liabilities etc.[222] Identifying a reliable valuation of these items may not always be possible, particularly where no market for the assets exist. The assessment of such assets and liabilities may therefore involve as much uncertainty and discretion of the arbitral tribunal as income-based approaches may necessitate.

The award in *Siemens v. Argentina* is frequently cited by commentators as an example where such issues had to be dealt with by an ICSID tribunal[223]. While the arbitral tribunal agreed to apply the book-value method for valuing damages, it examined adjustments to book value on only three aspects – interest rates, tax credits and risks associated with contract termination[224]. The tribunal did not factor the value added by management to the development of the project in dispute, which had already reached the stage of operation. This value added by the management should have been added as a part of the goodwill or other intangibles, thereby enhancing the project's value and consequently, the compensation that would have to be awarded. The tribunal's choice of adjustments (or lack thereof) is an important factor for consideration while applying ABV. Elements of arbitral discretion do percolate even into the book-value method.

B. Replacement Value

The replacement value method differs from book-value significantly by avoiding the usage of historical prices of the asset. Instead, this method seeks to find the amount that would have to be paid to replace the evaluated asset with an asset of similar kind, utility and condition[225]. The

[222] Shanon P. Pratt and Alina V. Niculita, *The Lawyer's Business Valuation Handbook* 2nd ed. (American Bar Association 2013)
[223] *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8 Award (17 January 2007)
[224] Ibid para 362
[225] Ripinsky and Williams (n 3) 219

IVS Guidelines describes the replacement value method (as 'replacement cost' method) in the following terms –

> Generally, replacement cost is the cost that is relevant to determining the price that a participant would pay as it is based on replicating the utility of the asset, not the exact physical properties of the asset[226].

The replacement value is therefore aimed finding the equivalent value of the asset that is expropriated or whose value may be diminished. The use of the replacement value method is based on the assumption that there are comparable assets in the market with which the value of the injured asset can be compared. On this aspect, this method largely resembles the market-based approaches to valuation like the comparables approach. However, like other asset-based methods, it provides a more accurate assessment of physical or tangible assets but may not include the value of intangibles like goodwill or future earning potential of the asset[227]. Historically, the replacement value method has found wide usage by courts and arbitral tribunals in valuing individual assets, such as ships[228], petroleum resources[229], drilling equipment[230] and other such high-value physical assets. In order to account for the depreciation of value that has occurred to the investment between the date of purchase and the date of expropriation or commission of unlawful act, a 'depreciated replacement value' may be used instead of determining the equivalent value of a replacement that is brand new. However, this may vary on a case-by-case basis, as some tribunals have also held that a 'new for old' replacement value as the fair amount to give effect to full reparation[231].

C. Liquidation Value

The liquidation value method is aimed at assessing the investment value that would likely be obtained in a liquidation process. This generally assumes that the subject investment has no future prospects, with the assets of the business sold individually[232]. The IVS Guidelines describe the liquidation value as the amount that would be realised when an asset or group of

[226] Section 70.2, International Valuation Standards
[227] Ripinsky and Williams (n 3) 220
[228] *The Corfu Channel Case (United Kingdom v Albania) (Merits),* ICJ Reports 1949, 4
[229] *Phillips Petroleum Company Iran v. The Islamic Republic of Iran, the National Iranian Oil Company* IUSCT Case No. 39 Award No. 425-39-2
[230] *Petrolane, Inc., Eastman Whipstock Manufacturing, Inc. and others v. Islamic Republic of Iran, Iranian Pan American Oil Company and others* IUSCT Case No. 131 Award No. 518-131-2 (14 August 1991)
[231] Marboe (n 3) para 5.256
[232] Ibid 5.263

assets are sold on a piecemeal basis[233]. Unlike other methods, the IVS does not consider liquidation value as a method of valuation, but rather as a basis for determining value. It also recommends that the liquidation value be premised either on the basis of an orderly transaction or a forced transaction[234], which would effect value accordingly. However, the IVS Guidelines on this regard has not always been followed by arbitral tribunals[235]. Sale of an asset under liquidation usually involves a 'distressed discount' arising from the fact that the asset is being sold at a forced sale and may therefore not reflect the fair market value arising in a normal market sale between third parties. Rather, tribunals have agreed to award the full value of the assets in question.

Most of the IUSCT cases involving liquidation value claims were assessed with the purpose of identifying market value, with hardly any application of the conditions of forced sale. While later tribunals also dealt with such valuation methods as submitted by parties[236], most tribunals have not applied adjustments to value based on the assumption of forced sale. In most of these cases, tribunals have resorted to methods such as adjusted book value or replacement value in order to assess the assets, although liquidation value may have been the ground stated by either of the disputing parties. As Marboe notes, the lower limit of claims for damages is usually the sunk costs in the investment, rather than liquidation value[237].

7.2.4 Other Approaches

Beyond the commonly-used methods described under the market, income and asset-based approaches of investment valuation, arbitral tribunals may also resort to means if necessary. The use of such methods may be motivated by a number of factors, including the lack of reliable inputs for using specific valuation methods, excessive speculation, unreliable evidence etc. Among the varied methods, the *sunk-costs* and the *mixed methods* approaches have been commonly applied by tribunals in investment disputes.

[233] Section 80.1, International Valuation Standards
[234] Ibid
[235] Marboe (n 3) para 5.263
[236] *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/26 (29 January 2016)
[237] Marboe (n 3) para 5.273

A. Sunk-Costs Approach

The sunk-costs approach entails the calculation of the total sum spent by the claimant on the investment in dispute. Based on calculations of the historic value of expenditures undertaken by the foreign investor, including purchase of assets as well as the costs incurred in planning and executing the investment. The sunk-costs approach is concerned with the *damnum emergens* component of damages and considerations of future profitability are not included in the calculations of investment value. The sunk-costs approach has generally been applied where investment in dispute has not started generating cash flows or does not have a history of operations that would enable forward-looking methods to be used reliably[238]. In instances involving such investments, tribunals often held in favour of awarding the amount equivalent to the "actual investment" in the project instead of income-based methods like DCF[239]. Like asset-based approaches, the backward-looking nature of sunk-costs provides an advantage to arbitral tribunals as costs incurred are easier to establish than the likelihood of future profits or cash flows.

The problem with the sunk cost approach lies in the fact that the historical cost of investment may not reflect its current fair market value, which has also been noted in the use of methods like book-value. Even though a large sum of money may have been invested in a project, it might still have a low or fair market value due a lack of success of the business or other factors. In contrast, businesses also get sold at a far higher value than the amount invested due to a successful product or service. Consequently, sunk-costs can often be a poor indicator of fair market value. Another limitation of the sunk-costs approach lies in terms of what it achieves – placing the investor in a position where the investment had never been made. By receiving solely the *damnum emergens* component of damages, the investor goes back to position where they were prior to making the investment but not where they would have been had the unlawful act not been committed, as per the full reparation principle[240]. Thus, in order to achieve full reparation, the investor must also receive the expected returns from the investment, either by payment of interest based on a reasonable rate of return, or as lost profits.

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[238] Ripinsky and Williams (n 3) 227

[239] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000) at para 122. See also, *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana* Award of Damages and Costs 95 ILR 211 (30 June 1990); *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3 Award (20 August 2007)

[240] Kantor (n 147) 51

Despite these limitations, arbitral tribunals have often made use of sunk-costs approach, though the lost profits component has been subject to claims of the disputing parties as well as the arbitral tribunal's discretion[241]. Some commentators have explained the rationale of arbitral tribunals of applying this approach as a means of achieving balance between the interests of investors and states[242]. DCF projections in certain cases may be too speculative and the resulting valuations may be perceived to be unfairly favouring investors. At the same time, using asset-based approaches like net book value would ignore the future prospects of the business and undervalue the intangible assets and liabilities involved, resulting in a more favourable award for the state at the cost of the investor. Since the sunk-costs approach takes a more balanced approach in terms of assessing the investments costs involved, the resulting valuation may be perceived to be more equitable by the disputing parties. In order to fulfil the applicable legal standards of fair market value or full reparation, tribunals may supplement or make adjustments to sunk-cost value by through lost profits and interest, as applicable.

B. Mixed Methods Approach

The mixed methods or hybrid approach to valuation is essentially the payment of additional compensation or damages for the loss of future profits combined with the valuation of an investment calculated on the basis of a sunk-cost or asset-based approach. In the early years of investor-state disputes, where tribunals were did not used income-based approaches as frequently, the mixed methods approach was used to ensure that both *damnum emergens* and *lucrum cessans* were accounted for while awarding compensation or damages[243]. In some of the older cases, the determination of certain lumpsum amounts for lost profits or lost business opportunities component is often left unexplained, with tribunals either referring to considerations of equity or their discretion in determining the appropriate amount. For instance, in *LIAMCO v. Libya*, the calculation of the oil production assets owned by the claimant were done using book value, which was supplemented with the payment of a lumpsum to account for the purpose of 'equitable indemnification' for the nationalization of the concession rights

[241] Tribunals have awarded lost profits in addition to sunk costs in certain cases where they have established the likelihood of such profits. In *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8 Award (17 January 2007) para 379 where the arbitral tribunal took the sunk-costs approach to value Siemens' investment but refused to allow lost profits in addition to sunk costs as they were unlikely to have materialised.
[242] Ripinsky and Williams (n 3) 231
[243] Marboe (n 3) para 5.275

by the respondent state[244]. An even more egregious case was *American Manufacturing and Trading Inc. v. Zaire*, where the majority tribunal doubled the amount of damages that had been calculated by the tribunal-appointed expert[245]. While the expert had calculated the total harm sustained to the amount of USD 4.452 million on an asset-based approach, the Tribunal awarded USD 9 million along with interest to the claimant, without explaining how it determined this amount[246].

The use of such lumpsum amounts was a way by which tribunals accounted for the enhanced value of an investment beyond the total value of physical assets or total costs incurred. In the absence of a proper method of calculation, such amounts were largely discretionary in nature[247]. Moreover, the separate calculation of asset value and lost profits based on different valuation methods may lead to double-counting as the variables used in one method may be repeated in the other. For instance, DCF may incorporate depreciation in the cash flows of an investment, that has already been accounted for in calculating its book-value. Where a certain method can adequately be applied for calculation of overall value, it may be preferable over mixed methods. But in cases where calculations like future profits are difficult to estimate, arbitrators end up resorting to discretionary means in order to fulfil the requirements set by the legal standards of compensation and damages[248].

7.2.5 Concluding Remarks on Valuation Methods

As the survey of valuation approaches and methods therein has shown, there are significant advantages and disadvantages inherent to each type of valuation and there are consequent trade-offs involved for each chosen method. Arbitral tribunals balance a number of considerations when deciding on the appropriate valuation method in a case, starting with the information available regarding the effects on investment value. Each of the major approaches to valuation require the availability of certain data. For instance, market approaches rely on the availability of comparable financial data or market information regarding transactions, while income-based methods require relevant data for estimating future cash flows and various risks involved.

[244] *Libyan American Oil Company v. The Government of the Libyan Arab Republic,* Award (12 April 1977) (1982) 62 ILR 141
[245] *American Manufacturing & Trading, Inc. v. Republic of Zaire*, ICSID Case No. ARB/93/1 Award (21 February 1997)
[246] This was also highlighted in the separate opinion of the dissenting arbitrator. See Statement of Individual Opinion and Declaration by Keba Mbaye (5 February 1997)
[247] Ripinsky and Williams (n 3) 232
[248] Ibid 235

Further, the nature and conditions relating to the investment in dispute are equally relevant. Arbitral tribunals have historically shown preference for asset-based approaches to valuation over income-based methods where the investment in question does not have a record of profitability or future cash flows are deemed to be unlikely. Although preferences may change over time, the nature and state of the investment will be the principal determinant of the information that is available for valuation. Parties must therefore be able to present sufficient evidence regarding such information to convince the tribunal in favour of a specific method. The tribunal will examine the reasons for applying a method, calculations involved and the evidence supporting such calculations in making its decision.

Secondly, the choice of a valuation method is not merely a legal assessment. Arbitral tribunals determine a suitable valuation method based on a variety of factual and economic considerations, with a significant degree of discretion involved therein. In the absence of rules, tribunals may develop specific methods of reasoning or tests to decide whether a certain valuation method is suitable. For instance, the two-step process suggested by the tribunal in *Tethyan Copper Company v. Pakistan* for determining the suitability of the DCF method is an appropriate example. As long as the choice of valuation method is subject to the satisfaction of the tribunal, it is inevitable that differing perceptions to the different valuation methods will lead to divergence in their application. Tribunals that are more concerned about speculation will take a more conservative approach to certain methods like DCF than others. Tribunals that are more comfortable with asset-based approaches will apply them on adjusted terms even where they may not be optimal for estimating fair market value.

The same rationale also applies to *how* arbitral tribunals apply the chosen valuation methods. As seen from the shifting preferences of tribunals over the years, income-based approaches that were generally avoided by tribunals in the 1980s-90s have now most frequently used in investor-state disputes. Tribunals have shown greater willingness to apply DCF than before, although the considerations of factors like past performance and future profitability continue to be relevant. Tribunals have also become more proactive in examining and applying adjustments to the most minute variables used in the mathematical models under such approaches. This is another aspect where arbitral discretion seems to play a key role, as adjustments to the input values can have a tremendous effect on the resulting valuation.

Through its role in the selection and application of valuation methods, arbitral discretion can play an important part in the determination of the amount of compensation and damages. There is a clear difference in the investment value that will likely arise by the choice of forward or

backward-looking approaches to valuation. An enterprise which derives most of its value from intangibles will not be valued correctly using an asset-based approach. Similarly, a market-based approach for an asset or enterprise which is unique and cannot be easily transacted will not yield an accurate picture of its fair market value. The choice of valuation method can consequently have an upward or downward effect on the fair market value estimate of the investment.

Thirdly, some commentators have also noted the role of equitable discretion of tribunals regarding the choice of valuation methods[249]. Such equitable discretion may be viewed as a part of the larger role of equitable considerations in the assessment of compensation and damages, as previously examined in Chapter 2. Ripinsky and Williams have indicated that the consideration for a 'balanced' approach to the interests of disputing parties may be a reason for adoption of methods like sunk-costs valuation by tribunals[250]. While tribunals occasionally refer to equitable considerations as a factor in the assessment of compensation and damages, it is not clear whether such considerations must, as a principle, be reflected in the choice of valuation. Where the legal standards are clearly specified and different valuation approaches are suggested by the disputing parties, tribunals generally regard 'appropriateness' of a particular method as more crucial than equitable considerations. The *Crystallex v. Venezuela* tribunal's pronouncement summarises the general perception among tribunals well:

> A tribunal will thus select the appropriate method basing its decision on the circumstances of each individual case, mainly because a value is less an actual fact than the expression of an opinion based on the set of facts before the expert, the appraiser or the tribunal[251].

However, it may be admitted that even a decision regarding the appropriateness of a valuation method is inherently discretion-based and may therefore involve equitable considerations, even if such considerations are not necessarily spelled out in the award. It is this very aspect of opacity that accompanies arbitral discretion that makes it difficult to dissect certain decisions taken by arbitral tribunals. Even if equitable considerations are involved in the choice of a particular valuation method, it would not be possible to establish it with certainty, unless the tribunal specifies it in the award.

[249] Elrifai (n 1) 840
[250] Ripinsky and Williams (n 3) 231
[251] *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award (4 April 2016) para 886

8. Interest

Any award of compensation or damages is incomplete without the component of interest that compensates the claimant for the loss of use of money. From the instance of the act of expropriation or breach of international law, there is usually a significant period of time until the actual payment of compensation or damages is made to the claimant. Any payment of compensation or damages compensate the claimant for this period of delay during which the claimant cannot make use of the money that is due. On the other hand, respondents are unjustly enriched as they retain the use of money that is owed to the claimant during the same period. Consequently, the award of an appropriate rate of interest on the overall amount of compensation or damages performs the function of compensating the claimant as well as preventing unjust enrichment of the respondent at the claimant's expense. Domestic and international courts around the world have recognised these crucial functions of interest since the beginning of modern commercial adjudication, although the manner of awarding interest has varied significantly[252]. In addition to these stated functions, Gotanda has proposed a third function of interest as a deterrence against opportunistic actions by respondents. There cannot be full compensation of a claimant without an award of interest. Consequently, an award without interest may leave the respondent may be insufficiently deterred. They may even try to delay the resolution of the dispute because the respondent can profit from the use of claimants' money while the dispute is being resolved. Thus, interest awards encourage parties to avoid disputes as well as resolve them in a timely manner when they occur[253].

This third function relates more to a systemic benefit rather than the rights of parties in a given dispute. In the instance of investor-state arbitration, the interest component may discourage states (as respondents) from delaying any payments due as compensation or damages. Additionally, states may also be deterred from engaging with dilatory tactics during the arbitral process, knowing that interest will continue to accumulate where claimants have a high chance of receiving a favourable award. The same reasoning would also apply where damages are awarded against claimant-investors resulting from the respondent-state's counter claims[254].

[252] Thierry Senechal and John Y. Gotanda, 'Interest as Damages' (2009) 47 Columbia Journal of Transnational Law 3.

[253] John Y. Gotanda, 'Compound Interest in International Disputes', (2004) Oxford University Comparative Law Forum 1 <https://ouclf.law.ox.ac.uk/compound-interest-in-international-disputes/>

[254] Arbitral tribunals in certain cases have agreed to impose separate damages awards to claimant-investors and respondent-states arising from respective claims and counter-claims. Notably, in *Perenco Ecuador Ltd. v. Republic of Ecuador,* the ICSID Tribunal awarded $US 54.5 million to the respondent for counter claims arising from the environmental damage caused by the claimant-investor with post-award interest. See, *Perenco Ecuador*

Marboe characterises a similar function of interest as a tool for improvement of payment practices[255]. The party against whom a damages award is made, i.e. the award-debtor, will have an incentive to pay compensation or damages as early as possible. However, this incentive of making prompt payment is subject to the rate of interest. If the interest rate awarded by the tribunal is less than the market rate for borrowing, it would not create any additional incentive for the award-debtor to pay early, considering that the award-debtor would have paid more if the same amount of money was borrowed at market rates. In such a case, it is more profitable for the award-debtor to delay payment and generate a return from the unpaid sum of compensation/damages rather than borrow an equivalent amount from the market. Therefore, tribunals tend to award interest higher than the market rate in order to incentivise early payment by award-debtors.

While the hypothesis of whether interest actually promotes efficient transactions among parties remains to be tested, the investor-state dispute settlement regime has adopted interest as a crucial component of arbitral awards. As the principal legal sources for adjudication, investment treaties either make explicit reference to interest as a component of compensation and damages or through broad standards like 'prompt, adequate and effective' compensation that pre-suppose the inclusion of interest[256]. Additionally, the ARSIWA also provides for interest in the following terms, under Article 38. The ARSIWA spells out clearly that interest is neither an autonomous part of damages nor is it mandatory in every case. Instead, the fulfilment of the full reparation standard must guide any decision to award interest, along with the rate of interest and the method used for calculation. In contract-based disputes, parties have more leeway in terms of having a prior agreement on the rate of interest or a mutually selected benchmark to be used for determining the appropriate rate of interest that would be applicable to a future dispute. On the other hand, where the applicable law is the national law of a state, statutory interest rates may be applicable for the dispute at hand. In addition to textual legal sources, the power to award interest is recognised by commentators as an *inherent* power of arbitral tribunals[257], which has been supported by the IUSCT and ICSID Tribunals. In the noted case of *United States v. Iran,* the question before the IUSCT as to whether the Tribunal was entitled to award interest in the absence of an explicit enabling provision under the Claims Settlement

Ltd. v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador), ICSID Case No. ARB/08/6 Award (1 October 2019)

[255] Marboe (n 3) para 6.35

[256] Marboe (n 3) para 6.13

[257] Ripinsky and Williams (n 3) 364

Declaration of 1981[258]. The tribunal held that is customary for arbitral tribunals to award interest as part of an award for damages regardless of the absence of any express reference to interest in the agreement to arbitrate between disputing parties[259].

As the tribunal's observations make it clear, unless specifically excluded by the applicable law, arbitral tribunals can award interest along with compensation or damages as a matter of general principle of law[260]. Though the general applicability of interest in damages cases is now largely undisputed, the determination of the interest rate is generally the subject of much contention between disputing parties. Interest can inflate the total amount of damages greatly, and in some cases, even exceed the principal sum of compensation of damages determined by the arbitral tribunal[261]. Particularly when many years have elapsed between the date of expropriation or the commission of unlawful act and the date of award, even nominal interest can accumulate to a large amount. In the context of this present research, interest is particularly relevant due to the significant degree of arbitral discretion that is exercised in its determination. Consequently, this sub-section will not delve into the different methodologies of calculating interest but examine the discretionary elements that are involved in the process. Two aspects of interest that involve the exercise of arbitral discretion are examined below are (i) the choice of simple or compound interest, and (iii) pre-award and post-award interest.

Arbitral tribunals have attested to their discretion in the determination of appropriate interest rates for a long time. In *Wena Hotels v. Egypt*, the ICSID annulment committee was faced with the question of whether the arbitral tribunal's award of 9% interest, being 1% below the interest rate of Egypt's long term government bonds, fulfilled the requirement of providing sufficient reasoning under Article 52(1)(e) of the ICSID Convention. The annulment committee confirmed by observing that international tribunals have a "large margin of interest" in fixing interest. Regarding the tribunal's choice of the annulment award, the annulment committee held was of the opinion that it must be assumed that the tribunal took such a decision to give effect to the requirement of "adequate and effective compensation" as required by the applicable investment agreement to the dispute[262]. The annulment committee held that the reference to a rate which was 1% below the long-term bonds by itself fulfilled the reasoning

[258] *The Islamic Republic of Iran v. The United States of America*, IUSCT Case No. A19 (30 September 1987)
[259] Ibid para 12
[260] *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3 Award (20 August 2007) para 9.2.1
[261] See for instance, *Compania del Desarrollo de Santa Elena v. Costa Rica*, ICSID Case No. ARB/96/1 Award (19 February 2000)
[262] *Wena Hotels Ltd. v. Arab Republic of Egypt*, Decision on the Application by the Arab Republic of Egypt for Annulment of the Arbitral Award (5 February 2002), 41 ILM 933 (2002) para 96

requirement and no further reasoning was necessary. The annulment committee also referred to the lack of pleading on the part of the disputing parties about what should be the appropriate interest rate as a factor conferring a 'wide margin of discretion' to the arbitral tribunal[263]. The disputing parties had not asked for a specific interest rate but limited their pleadings to requesting for an 'appropriate' rate of interest. Therefore, the Committee felt that the tribunal's determination of 9% interest was well within its discretionary authority.

Some tribunals have stated that the tribunal's discretion is not completely unfettered, but subject to equitable considerations like fairness to the parties[264]. Additionally, some factors for consideration have also been proposed, such as those stated by the IUSCT in *McCoullogh v. Ministry of Post*[265]. Here, the Tribunal formulated a non-exhaustive list of factors that must be considered while determining the interest rate. This included criteria such as any pertinent contractual stipulations, applicable law of contract, factual background, nature if compensation awarded, market rates, inflation rate etc. However, these are merely criteria for consideration and do not yield a specific interest rate, which must still be determined by the tribunal. A uniform, systematic approach to interest rate determination does not exist in investor-state arbitration. Rather, the criteria involved in specific types of interest are examined for their appropriateness on a case-by-case basis.

8.1 Simple or Compound Interest

The choice of awarding interest at simple or compound rate has been the subject of much disagreement among tribunals[266]. Considering the significant difference in the final sum of money that would result from the application of the two methods, disputing parties are deeply invested in the tribunal choosing their preferred method. While compound interest has been widely used in all forms of financial transactions and services for decades, its application in investor-state arbitration is relatively recent. In fact, many arbitral tribunals until the 1990s continued to apply simple interest to damages awards[267]. The preference for simple interest

[263] Ibid para 97
[264] *Compania del Desarrollo de Santa Elena v. Costa Rica,* ICSID Case No. ARB/96/1 Award (19 February 2000) para 103
[265] *McCollough & Company, Inc. v. the Ministry of Post, Telegraph and Telephone, the National Iranian Oil Company and Bank Markazi* IUSCT Case No. 89 Award (16 April 1986)
[266] The difference between simple and compound interest lies in how interest is applied. Unlike simple interest, compound interest applies the interest rate to the principal amount as well as any prior interest that has accumulated. Consequently, the total amount increases at a much faster rate when compounded.
[267] Ripinsky and Williams (n 3) 384

among international courts and tribunals in the early 20th century was quite established. Writing in the 1930s, Whiteman observed that few rules on damages in international law were better settled than the one that compound interest is not allowable by international courts and arbitral tribunals. Although in rare cases compound interest had been granted, tribunals have been almost unanimous in disapproving its allowance[268].

The consideration of compound interest almost as an exceptional remedy continued during the practice of the IUSCT starting in the 1980s, where the Tribunal would unanimously grant simple interest to the exclusion of compound interest, often accompanied by reference to Whiteman's observations[269]. According to Beeley, the suspicion against compound interest among arbitral tribunals was possibly due to three reasons: concerns against claimants collecting windfall damages, the backdrop of domestic common law prohibiting usury or rates higher than simple interest, and thirdly, a preference for following past arbitral practice rather than engaging with the complex calculations involved in a given dispute[270]. However, not all tribunals followed this norm, with notable cases like *Starett Housing v. Iran* bringing to attention the diverging opinions of arbitrators. In his concurring opinion in this case, Judge Holtzmann criticised the tendency of tribunals to rely on Whiteman's treatise in support of the proposition that awarding simple interest was a 'well-settled rule'. According to Holtzmann, such a proposition was no longer appropriate or justifiable in modern arbitral practice, noting that considerations of equity itself required that compound interest be awarded, particularly since claimants often suffered costs due to charges that compounded over time[271].

In the light of these contrasting views, the Commentary to the ARSIWA also points to the largely unsettled position regarding the award of compound interest[272]. While observing the predominant practice of tribunals to award simple interest, the Commentary noted the scholarly criticism on the subject and the rising number of cases where tribunals preferred to apply compound interest[273]. In the absence of any uniform approach to questions of quantification and assessment of amounts of interest payable, the Drafting Committee saw it fit to leave it to

[268] Whiteman (n 6)
[269] *R.J. Reynolds Tobacco Co.* v. *The Government of the Islamic Republic of Iran,* Iran-U.S. C.T.R., vol. 7. 181, (1984)
[270] Mark Beeley, 'Approaches to the Award of Interest', in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 371
[271] *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others* IUSCT Case No. 24 Concurring Opinion of Judge Holtzmann
[272] Commentary on Article 38 ARSIWA
[273] The views presented by F.A. Mann in his article on compound interest were approvingly cited in the ARSIWA Commentary. See, F. A. Mann, 'Compound Interest as an Item of Damage in International Law' (1988) 21 U.C. Davis Law Review 577

arbitral tribunals to base such determinations against the full reparation standard. Thus, the onus would be upon the party claiming damages under the full reparation standard to convince the tribunal regarding the necessity of compound interest.

The 2000s marked a shift in arbitral practice in favour of awarding compound interest that has continued till today. In a survey of interest rates applied in ICSID awards between 2000 and 2016, Dow found that over 80% of the 167 damages awards surveyed had applied compound interest[274]. Although there was significant variation in the rate applied, the findings clearly point towards the preference for compound interest. Some commentators like Ripinksy and Williams have attributed this development partly as a response to scholarly criticism regarding the lack of acceptance of compound interest, even though it was widely applied within the larger economic milieu where the subject investments were presumably situated[275]. The works of Gotanda and Mann have been particularly credited in this regard. Mann had developed further on critiques such as by Judge Holtzmann in holding the continued reliance on simple interest by tribunals as a lack of recognition of basic economic realities of businesses and how financing of businesses was done.[276] Gotanda further added to these prior assessments through comparative studies of the application of interest rates across different jurisdictions and legal systems. He noted how most financing and investment vehicles by which investors conduct their businesses involve the payment of compound interest. For the purpose of promoting compensation and restitution, simple interest falls short of attaining those goals. Additionally, no rule international law prohibited the award of compound interest[277].

Scholarly opinion aside, arbitral tribunals at the turn of the 21st century seemed to have also warmed up to the notion of bringing arbitral practise in alignment with economic principles with respect to the aspect of interest. Some of the awards that were marked this shift were *Compania del Desarrollo de Santa Elena v. Costa Rica*[278], *Metalclad v. Mexico*[279], *Maffezini v. Spain*[280] among others. Among the varied considerations for awarding compound interest, factors such as whether the claimant would have earned compound interest on the unpaid amount or incurred costs due to non-payment in a compounded manner became crucial to the

[274] James Dow, 'Interest' in John A Trenor(ed.), *Global Arbitration Review Guide to Damages in International Arbitration*, Law Business Research Ltd. 2018)
[275] Ripinsky and Williams (n 3) 384
[276] Mann (n 274) 585
[277] Gotanda (n 254)
[278] *Compania del Desarrollo de Santa Elena v. Costa Rica*, ICSID Case No. ARB/96/1 Award (19 February 2000)
[279] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000)
[280] *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award (13 November 2000)

tribunal's determination. Despite this trend, however, simple interest has continued to be applied in certain instances by arbitral tribunals. Simple interest has continued to be applied in cases, including the following scenarios: where it is pre-determined via contract provisions[281], where interest is awarded based on national law that does not permit compound interest[282], where the subject matter concerned the lack of enforcement of previous arbitral award that already had an interest component without compounding[283], where the claimant was unable to prove that they would have earned or incurred compound interest[284], among other situations.

Most importantly, tribunals have in many instances affirmed their discretion to award the appropriate type of interest. In the absence of an international legal principle regarding the issue, tribunals have supported the notion that the appropriateness of the type of interest should rather be decided on a case-by-case basis. For instance, the tribunal in *Rosinvest v. Russia* affirmed its authority to make its own assessment regarding the Claimant's situation and the nature of the investment in deciding whether compound interest rate should be awarded. It held that a tribunal could choose to apply any form of interest that it deems appropriate, provided that it considers the damage done and nature of investment in question. The tribunal is not bound to award either simple or compound interest only[285].

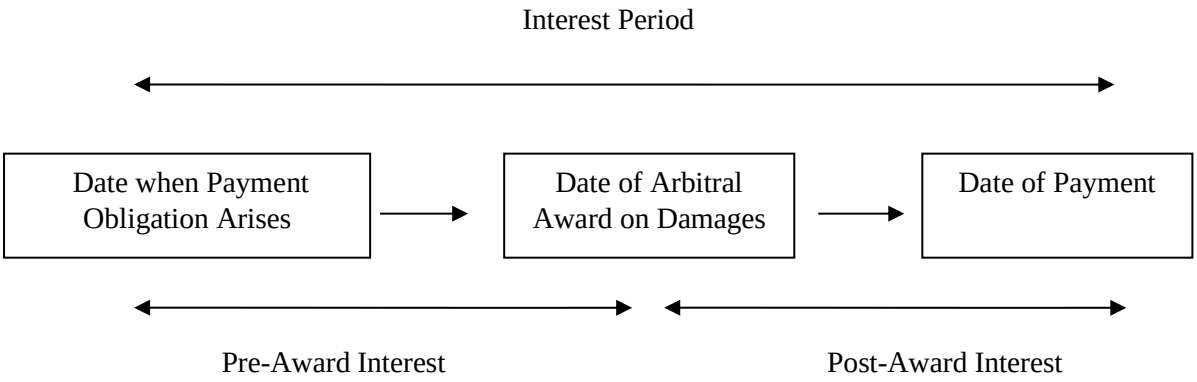
As seen above with regard to the choice of valuation method, arbitral tribunals have followed considerations of appropriateness on the basis of the facts of the case in choosing between simple and compound interest. Despite a growing tendency of tribunals to award compound interest, the factual scenario and the nature of investment are the essential determinants in such decisions. While tribunal practice has tended to align more closely with the functioning of markets, they continue to retain discretion in making the final determination.

[281] *Pluspetrol Perú Corporation and others v. Perupetro S.A*, ICSID Case No. ARB/12/28 Award (21 May 2015)
[282] *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19 Award (18 August 2008)
[283] *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07 Award (30 June 2009)
[284] *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4 Award (29 December 2004)
[285] *RosInvestCo UK Ltd. v. The Russian Federation*, SCC Case No. V079/2005 Award (12 September 2010)

8.2. Pre-Award and Post-Award Interest

Pre-award interest serves as the interest component that is calculated between the date on which damages or compensation arises up to the date of the arbitral award. On the other hand, post-award interest is applicable from the date of the award until the payment that is due to the claimant has been discharged. As the purpose of interest is to compensate the claimant for the loss of use of money between the date by which payment became due until the actual payment, the date of the award in the intervening period usually has no functional significance. The overall scheme can be understood from the following illustration:

Figure 3: The two components of interest



In order to fulfil the function of interest, the interest rate that is determined by the tribunal until the award that should, therefore, continue to apply until the date of payment. However, several tribunals in investor-state disputes have made a distinction between the two components on certain grounds. Firstly, pre-award interest is quantified in the arbitral award in the form of a specific sum of money. For example, if a tribunal determined USD 1000 as the principal amount of 'damages' on which 6% simple interest accrued over one year until the award date, the amount of interest due would be USD 60, which could be stated in the award. However, the post-award component cannot be quantified as a sum of money within the arbitral award itself as it accrues after the award has been made by the tribunal and until it is paid at some point in the future.

Secondly, post-award interest serves an added function as an incentive for the award-debtor to comply with the terms of the arbitral award as soon as possible[286]. If the award-debtor elects to pay the sum owed to the claimant in an expedited manner, the post-award interest amount would

[286] Marboe (n 3) para 6.261

consequently be smaller. However, this advantage does not arise in the case of pre-award interest as it corresponds to the interest that has already accrued until the date of determination, i.e. the award date. Where a tribunal expects non-compliance or dilatory tactics to be used by the award-debtor, it can raise the potential costs of such non-compliance by determining a higher rate on the post-award component of interest. However, this rationale has proven to be rather controversial due to the likelihood for such measures to be seen as punitive damages rather than compensatory in nature[287].

Although the pre- and post-award components are generally recognised, arbitral tribunals have also taken diverging approaches regarding the decision to actually grant the two components separately. Many tribunals have allowed interest to run continuously until the date of payment, thereby making no separation on the basis of the award date[288]. Others agreed to separate award of post-award interest, but subject to certain considerations. For instance, the obligation to pay may arise only on the date of the award[289]. Additionally, tribunals have also agreed to 'grace periods' for compliance after an award date, following which post-award interest may begin to accrue. For instance, in *Lemire v. Ukraine*, both of these factors arose for consideration by the arbitral tribunal. With respect to the accrual of interest, the tribunal held in the case that the date of the award would be the right date as it would be the date on which the actual amount of damages is established, the date when Respondent's obligation to pay the compensation arises and, as a result, the appropriate date for interest begins accruing[290].

Different rates of interest at the pre- and posr-arbitral stage is a common practice. For instance, the tribunal in *Occidental Petroleum v. Ecuador* applied two different bases of interest rate for the pre-award and post award components[291]. For pre-award interest, the Tribunal awarded interest based on the US Government Treasury bill rate at 4.188% per annum, which it considered to be a "prudent, risk-free and conservative re-investment practice". For the post-award interest, however, the Tribunal elected for the U.S. 6-month LIBOR rate that would be compounded on a monthly basis[292]. The comparatively higher rate imposed in the form of the

[287] International investment treaties as well as the international law of state responsibility prohibit punitive damages. See, Crawford (n 14) 524
[288] *Fedax N.V. v. The Republic of Venezuela*, ICSID Case No. ARB/96/3 Award (9 March 1998); *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5 Award (23 September 2003); *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4 Award (29 December 2004); *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL Final Award (14 March 2003)
[289] Marboe (n 3) para 6.2.68
[290] *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18 Award (28 March 2011) para 363
[291] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11 (5 October 2012)
[292] Ibid para 849

compounded 6-month LIBOR rate as post-award interest reflects the point raised earlier regarding the tendency to induce efficient compliance after the award has been made. Though the tribunal in *Occidental Petroleum* did not explicitly state as such, it is apparent that the Tribunal's concerns about the unpredictability of the respondent's settlement of the payments due was a crucial factor. Similar decisions were also made regarding post-award interest in *Metaclad v. Mexico*[293], *CMS v. Argentina*[294], *Yukos v. Russia*[295] etc. The *Yukos* case is notable due to the Tribunal's consideration of the fact that the amount of damages awarded to the claimant was already considerable. The Tribunal therefore awarded simple interest as pre-award interest, even though it observed that awarding compound interest had become the norm in investor-state disputes[296]. It however decided to award post-award interest equivalent to the pre-award interest rate but compounded annually, accruing after a 180-day grace period[297].

Some crucial questions arise at this stage regarding the arbitral tribunal's role in considering and awarding post-award interest as a separate component, particularly where it is awarded at a higher rate. It is clear that there no legal rules or principles that govern arbitral decision-making in this regard and tribunals take a largely discretionary approach. In some cases like the *Sempra v. Argentina* award, the tribunal decided not to award post-award interest as it was not expressly prayed for in the parties' prayers and submissions. [298]

As with the case of deciding between simple and compound interest, the decision regarding separate post-award interest has also been subject to arbitral tribunals' consideration of what it considers to be appropriate. Tribunals assess such claims largely on a case-by-case basis and decide accordingly. However, in many cases where tribunals have awarded post-award interest, a higher rate of interest has been imposed. Commentators have disagreed on whether such higher interest can be considered to be punitive. According to Marboe, a higher rate of post-award interest reflects the respondent-state's default risk, which is the risk of the state not honouring the award[299]. If a respondent state's risk of default is high or its political or economic situation is unstable, the state's cost of borrowing money from the market is likely to be higher. As per Marboe, the higher post-award interest may reflect this higher cost of borrowing, and

[293] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000)
[294] *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8 (12 May 2005)
[295] *Yukos Universal Ltd. v. Russian Federation*, UNCITRAL, PCA Case No. AA 227 (July 18, 2014)
[296] Ibid para 1689
[297] Ibid para 1691
[298] *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16 Award (28 September 20070. Notably, Arbitrator Lalonde dissented from the majority on this aspect, considering the award of interest until the payment date to be crucial for the full reparation. See Separate Opinion.
[299] Marboe (n 3) para 6.283

not a punitive element. On the other hand, Ripinsky and Williams are more sceptical on this aspect, as they see higher rates of post-award interest as largely a measure of inducing compliance with the arbitral award through the "punitive element" of a higher interest rate[300].

The problem is further compounded by the fact that tribunals do not adequately state the reasons for a higher rate of post-award interest. As seen in the cases mentioned above, tribunals largely state their position regarding the appropriateness of the rate being considered but do not follow up with precise reasoning as to why the respondent-state must bear the risk of non-payment through a higher interest rate. Even if there are valid financial reasons, such as the risk of non-payment of the damages due, the reasoning (or lack thereof) renders such decisions rather opaque and arbitrary. The rejection of a differentiated approach to pre-award and post-award interest seems more reasonable, considering the purpose which is fulfilled by interest. The continuation of the pre-award interest rate until the date of payment, as already done in several arbitral awards, reflects the lack of any added risk in the post-award phase.

9. Conclusion

The examination of the legal standards of compensation and damages, valuation methods and interest has revealed the varied levels of assessment that is undertaken by arbitral tribunals in order to correctly make legally and financially sound awards on damages. While the differing legal standards of compensation and damages are recognised, their operation in practice are far more fluid. The principal case in point is the use of fair market value as the valuation basis for both compensation and damages cases despite the objective-subjective differentiation in the respective approaches. The necessity of substantive arbitral discretion is apparent, given that tribunals must be satisfied of the appropriateness of the legal standards, valuation methods and interest rates on the basis of which the claimant's legal right to compensation or damages must be fulfilled. The margin of discretion widens, although arbitrators are bound to explain their choices and the reasoning applied.

A detailed examination of the various approaches to valuation of compensation and damages has revealed the particular advantages and drawbacks associated with each system, along with the degree of estimation that may be necessary. The income-based approach, particularly the discounted cash flow method has revealed some of the persistent problems in valuation in the

[300] Ripinsky and Williams (n 3) 389

context of a legal dispute, and the manner in which arbitral tribunals have tried to formulate their approach in the absence of any formal guidance. The choice of valuation method as well as the manner of application of the method have their own distinct role in the final outcome, i.e. the investment value. In the next chapter, the examination will move from determination of damages to their adjustment, including the various legal grounds that enable tribunals to make such adjustments to investment value.

Chapter 4

Discretion in the Application of Principles Reducing Compensation and Damages

1. Introduction

In the previous chapter, the legal standards and valuation methods that are used to 'build-up' the quantum of compensation or damages were studied. It was noted how arbitral discretion pervades the decision-making process in this respect, given that legal norms are largely limited to the specification of standards of compensation and damages. The choice and manner of application of valuation methods and interest rates are subject to what an arbitral tribunal deems to be 'appropriate', given the facts, evidence and positions of disputing parties in each case. This chapter continues with the examination of the roles of arbitral discretion, turning the attention to process by which arbitral tribunals limit or reduce the calculated quantum. As the final stage of assessment of compensation and damages, tribunals convert the calculated business value to a final compensation/damages amount while ensuring that any amount does not exceed the actual loss suffered by the claimant. This stage is crucial for both investors and states given the significant alterations to quantum that are possible. As seen previously, there is also a significant scope for discretion when the legal principles governing limitations to compensation and damages are translated into actual adjustments to valuations. These are further elaborated in this chapter.

Among the various considerations for the tribunal at the stage of application of adjustments to the value of quantum, the actions of the claimant-investor come under particular scrutiny. As a general principle of law, the injured party's own actions that have contributed to the losses must not form a part of compensation or damages. Similarly, the additional losses that could have been mitigated by the injured party had they taken reasonable measures must also not form part of the final quantum of compensation. Both categories of instances which shift the focus inquiry from the respondent-state's unlawful actions towards the injured claimant-investor are the chief subject of assessment in this chapter.

This chapter is organised as follows: it comprises of a brief introduction to the principles reducing compensation and damages in Section 2. This is followed by the three substantive

heads of discussion in this chapter: causation in Section 3, contributory fault in Section 4 and mitigation in Section 5. In each part of the analysis, the role of arbitral discretion in the decision-making process of the tribunal is discussed, along with relevant cases and analysis of scholarly opinion. Based on the findings, a conclusion is presented in Section 6.

2. Principles Reducing Compensation and Damages

The amount of compensation or damages that is determined by an arbitral tribunal is limited to the extent of the 'actual loss' suffered by the injured party. Since there is a general prohibition against punitive damages under the international law of state responsibility as well as under investment treaties, it is evident that the any remedy granted under international investment law must be *compensatory* in nature[1]. The function of legal principles limiting compensation lies in ensuring that only compensation for losses actually suffered by the claimant due to the respondent's actions are awarded. The principles forming the core of such assessments by arbitral tribunal include causation, contributory fault and mitigation of damages. Additional factors weighted by tribunals include uncertainty or speculative nature of losses, avoidance of double recovery and other equitable considerations[2]. Some more factors that may lead to adjustments in compensation include investment risk, circumstances precluding wrongfulness and the state's ability to pay[3]. However, most of these principles besides causation, contributory fault and mitigation are applicable either in the stage of calculating the amount of compensation (discussed in Chapter 3) or in terms of exclusion of specific heads of claims from the valuation exercise altogether (such as a situation of necessity precluding wrongfulness). Since these factors do not have a direct effect in terms of adjustments of value, they are not examined here[4]. The principles of causation, contributory fault and mitigation that are raised for the purpose of reducing compensation and their interaction with arbitral discretion are therefore analysed in detail in this chapter. It must also be noted that though these principles

[1] James Crawford, *State Responsibility: The General Part* (Cambridge University Press 2013) 524
[2] Borzu Sabahi, Noah Rubins and Don Wallace Jr., *Investor-State Arbitration* (Oxford University Press 2nd ed. 2019) 719
[3] Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (BIICL 2008) 313
[4] For an analysis of various principles that have an effect on compensation and damages, see Borzu Sabahi, Kabir Duggal and Nicholas Birch, 'Principles Limiting the Amount of Compensation' in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 325

may apply independently at the stage of making adjustments to compensation, there is significant overlap among them conceptually.

The task of transforming these principles limiting compensation to actual mathematical adjustments to the amount of compensation or damages is complex and often proves to be controversial[5]. Often, the reasoning behind a tribunal's decision to reduce compensation by a specific quantity due to factors like contributory fault is not even clearly specified in the award. In the absence of relevant data, evidence or arbitral precedent, tribunals invoke their discretion assign such a factor or percentage that is deemed to be most appropriate or equitable to both parties. However, the turn towards discretion by a tribunal can become problematic if tribunals apply discretion as a form of substitute for coherent reasoning behind their decisions. For instance, a tribunal may "deem it fit" to reduce damages by 30% due to a specific contributory fault of the claimant, without explaining why it applied 30% as the adjustment factor, as opposed to any other percentage. In the absence of clear and coherent reasons, the decision made by the tribunal becomes subject to challenge by the disputants. Such awards can further raise questions as to the fairness and transparency of the entire arbitral process. For better understanding various problems involved with the application of discretion in this context, some of the principles limiting compensation and damages and their application are discussed in more detail.

Causation is the first step towards understanding the rationale for applying controls on the process of ascertaining damages. An inquiry into causation does not directly contribute to an act of reduction of compensation of damages since the exclusion of causation implies the exclusion of liability for a particular head of claim for losses. Although inquiries into mitigation and contributory fault fall properly within the later-stage of quantum determination, the proper place of causation analysis continued to be the subject of some divergence in arbitral practice, as we will see later. Therefore, causation is examined in the next section as the appropriate starting point towards understanding the application of the more specifically applicable factors of contributory fault and mitigation of losses that follow afterwards.

[5] Borzu Sabahi and Kabir Duggal, 'Occidental Petroleum v Ecuador (2012): Observations on Proportionality, Assessment of Damages and Contributory Fault' (2013) 28 ICSID Review 2, 279

3. Causation

The principle of causation seeks to enforce the rule that compensation or damages should only be awarded for losses arising from actions of the State. The party seeking compensation must establish a causal link between its losses and an internationally wrongful act, including unlawful expropriation. It is a general principal of law[6] that has also been incorporated into Article 31 of the ARSIWA as follows:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

Generally, the cause of an injury may be attributable to a host of factors, each contributing in various extents to the injury suffered by a party. Certain actions by a party leads to a number of consequences, not all of which may necessarily result in an injury. Therefore, the causation principle seeks to isolate the relevant acts *causing* injury for which state responsibility is specifically attracted. The ILC commentary to the ARSIWA notes that only injury "caused by the internationally wrongful act of State" is the proper subject of reparation, rather than any or all consequence that may flow from an internationally wrongful act.[7]

The assessment of causation is essential to the arbitral tribunal's eventual decision of whether compensation or damages must be awarded. Tribunals seek to establish a clear connection between unlawful or infringing state actions and the injury caused consequently by such actions. Analysis on causation in investment disputes is based on the *factual-legal cause theory*, involving a two-part assessment of factual and legal causation[8]. The determination of factual causation seeks to establish the necessary connection between a consequence and its antecedent action, most commonly by means of a 'but-for' or counterfactual assessment. In the same manner in which the counterfactual scenario is assessed under the full reparation principle, the tribunal examines whether a particular injury would have occurred if a certain state action or set of actions had not been carried out. This process of determination may become complicated

[6] Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Cambridge University Press 1953); See also, Zeno Crespi Reghizzi, 'General Rules and Principles on State Responsibility and Damages in Investment Arbitration: Some Critical Issues' in Andrea Gattini, Attila Tanzi, and Filippo Fontanelli (eds.), *General Principles of Law and International Investment Arbitration* (Brill Nijhoff 2018)

[7] Commentary on Article 31, Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001, *Yearbook of the International Law Commission*, 2001, Vol. II, Part Two

[8] Martin Jarrett, *Contributory Fault and Investor Misconduct in Investment Arbitration* (Cambridge University Press 2019) 43

when concurrent set of actions are involved in an injury, involving even the actions of the foreign investor or the conduct of third parties[9]. Any quantum of losses not attributable to the respondent state's actions must consequently be reduced from the total amount of compensation or damages.

Since factual causation may lead to the identification of multiple strands of relevant and non-relevant causes, legal causation attempts to separate such relevant causes that can be properly attributed to state action. Under legal causation, any factual causation must be *legally relevant* to the consequential injury. Where factual causation also passes the test of legal causation, arbitral tribunals refer to it as 'proximate cause', 'direct cause', 'prevailing cause', 'sufficient cause', etc.[10] Neither investment treaties nor procedural rules of arbitration provide for any specific legal tests for causation. Instead, the varied understandings of the terms like proximate, direct, foreseeable, etc. are applied by arbitral tribunals in their decision-making process. For instance, the tribunal in *Blusun v. Italy* used the term 'operative cause' as the determinant of causation[11]. This may be contrasted with an older case like *S.D. Myers v. Canada*, where the tribunal applied the term 'sufficient causal link' as stated as follows:

> Compensation is payable only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached; the economic losses claimed by SDMI must be proved to be those that have arisen from a breach of the NAFTA, and not from other causes[12].

Although the manner of expression may vary, the principle of causation serves the purpose of establishing the link between the occurrence of breach and its consequential injury. Although the fact of causation (or its lack thereof) under a particular head of claim for damages is essential to such determination of damages, causation does not by itself help determine the amount of damages. Rather, quantification of damages is a step subsequent to the establishment of causation. Beyond the determination that losses have been cased, claimants must also establish to the tribunal's satisfaction that the claimed amount of compensation or damages accurately reflects the extent of injury. This separate analysis is reflected in the "three-step process" used by tribunals in the determination of damages, the steps of which were summarised by the tribunal in *Deutsche Telekom v. India* as: (1) establishing that a breach has occurred (2) ascertaining

[9] Ripinsky and Williams (n 3) 140
[10] Jarrett (n 8) 45
[11] *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, ICSID Case No. ARB/14/3 Final Award (27 December 2016) para 394
[12] *S.D. Myers, Inc. v. Government of Canada*, First Partial Award (13 November 2000) para 316

that the injury was caused by that breach, and finally (3) determining the amount of compensation due for the injury that has been caused (quantification of damages)[13].

The distinction between steps (2) and (3) of the assessment is also made more evident by the fact that tribunals apply different standards of burden of proof at each stage. The tribunal in *Bilcon v. Canada* distinguished the comparably higher standard of burden of proof that must be discharged in establishing causation. The tribunal observed that the party that has the burden of proof must discharge it by showing that the alleged injury "in all probability" or with a "sufficient degree of probability" was caused by the breach[14]. On the other hand, a lower standard of burden of proof must be discharged by the injured party at step (3). The tribunal in *Lemire v. Ukraine* stated the oft-quoted position as follows:

> once causation has been established, and it has been proven that the *in bonis* party has indeed suffered a loss, less certainty is required in proof of the actual amount of damages; for this latter determination Claimant only needs to provide a basis upon which the Tribunal can, with reasonable confidence, estimate the extent of the loss.[15]

As long the tribunal is provided with such as basis to estimate losses with "reasonable confidence", the injured party's burden of proof is considered to be discharged. Similarly, the *Crystallex v. Venezuela* expressed its position regarding the extent of certainty that is required in assessing claims for damages. First, it is necessary for the claimant to prove with certainty that there is in fact the existence of damage. Here, the standard of proof is the same as applied to issues of merits. Once damage has been so established, a claimant should not be required to prove the precise quantification of damages with the same degree of certainty[16]. The tribunal justified this by reasoning that damages, particularly future losses, are difficult to determine with certainty. Therefore, a stricter requirement would place an unsurmountable burden on the claimant.

Despite the conceptually distinct inquiries causation and quantification, arbitral tribunals have generally dealt with issues of causation at the stage of assessing quantum. Scholarly works on investment treaty arbitration have addressed causation not as a subjective of analysis but as a

[13] *Deutsche Telekom v. Republic of India*, PCA Case No. 2014-10, Award on Quantum (27 May 2020) para 119
[14] *Bilcon of Delaware et al v. Government of Canada*, Award on Damages, PCA Case No. 2009-04 (10 January 2019) at para 110
[15] *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18 Award (28 March 2011) para 246
[16] *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award (4 April 2016) para 867

factor for consideration while calculating compensation and damages[17]. Because of the common practice of arbitral practice to divide awards into distinct stages of "liability" and "quantum", causation analysis often received only cursory attention of arbitrators and counsels[18]. However, the focus on causation has increased considerably in recent years given the increasing complexity of cases and difficulties posed by state actions that are hard to disentangle from other non-related factors causing losses to foreign investors.

Each individual head of claim that does not pass the factual-legal test of causation leads to the dismissal of any amount claimed by the injured party under that specific head. Therefore, even though causation by itself does not directly determine the amount of compensation or damages, the failure to establish causation for a specific claim leads to the rejection of the claim and the sum of money attached to that claim. Arbitral awards with findings of state liability but no damages are relatively rare but not completely absent from the investment treaty regime, arising from factors including the failure to satisfactorily establish causation[19].

The correct place for arbitral inquiry into causation continues to be the subject of divergence in among arbitral tribunals. While some tribunals have considered causation as a distinct part of their analysis between the stages of liability and quantum, it is more common to see tribunals deal with causation only at the final stage of quantum assessment[20]. Some scholars ascribe the latter approach as a result of the preponderance of the common law tradition, wherein causation is treated a part of the inquiry into the determination of damages arising out of tort actions, such as negligence[21]. Treatises on remedies under English tort law tend to read causation closely with mitigation and contributory negligence as factors limiting compensation[22]. Further, causation analysis is itself at a rudimentary state in public international law, with limited efforts having been made towards a systematic approach to causal inquiry[23]. Since it is beyond the

[17] Patrick W. Pearsall and J. Benton Heath, Causation and Injury in Investor-State Arbitration in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 84

[18] Ibid. See also, *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008); *Chevron Corp. (USA) & Texaco Petroleum Co. (USA) v. Republic of Ecuador*, PCA Case No. 34877, Partial Award on the Merits (30 March 2010)

[19] Jose Alberro, 'Liability Yes; Damages No. Consolation without Monetary Compensation: When Tribunals Rule for Claimant on the Merits and Award No Damages' (2019) Transnational Dispute Management Journal 2

[20] Wolfgang Alschner, 'Aligning Loss and Liability – Towards an Integrated Assessment of Damages in Investment Arbitration' in Carpenter, Jansen and Pauwelyn, *The Use of Economics in International Trade and Investment Disputes* (Cambridge University Press 2017)

[21] Pearsall and Heath (n 17). See also, H.L.A. Hart and T Honore, *Causation in the Law*.(OUP 2nd ed. 1985) Ch 6

[22] Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (Cambridge University Press 2nd ed. 2005) Ch 19

[23] Ilias Plakokefalos, 'Causation in the Law of State Responsibility and the Problem of Overdetermination: In Search of Clarity' (2015) 26 European Journal of International Law 2, 472

scope of the present research work to delve into a detailed discussion on the correct place of causal analysis, it will be enough here to indicate towards the non-uniformity of international arbitral practice on this question. The principle of causation is however weaved into the related concept of contributory fault, which forms a distinct part of analysis on quantum and will therefore be examined next. The legal principle of contributory fault (or contributory negligence), as examined next, seeks to place limitations on compensation for injury *caused* by injured party's own actions. The manner in which such contributory fault is quantified continues to be the subject of great controversy.

4. Contributory Fault

The principal of contributory fault, referred alternatively as contributory negligence, comparative fault, and contribution to injury, among others[24], is well-recognised in the law and practice of international and domestic legal systems. From the lens of the award of compensation and damages, the contributory fault of an injured party is frequently classified as a factor reducing the amount calculated for the stated purpose. Article 39 of the ARSIWA characterises contributory fault in the following terms:

> In the determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.

The ILC commentary to Article 39 explains the principle of contributory fault as a corollary of two principles: (1) that full reparation is due for the injury, and nothing more, arising as a consequence of an internationally unlawful act, and (2) fairness between the responsible State and the victim of the breach of international law[25]. The first principle is essentially a reiteration of Article 31 of the ARSIWA, which permits reparation only for injury caused by those specific actions that are held to be "internationally wrongful acts". There may be multiple, concurrent acts connected to an injury, but it is the arbitral tribunal's responsibility to identify and remedy only such internationally wrongful acts. Therefore, the injured party cannot be permitted to go scot-free for its own actions or omissions that may have contributed to its injury. The absence of such a prohibition would allow the injured party to gain an unfair advantage out of its own prejudicial actions. Further, Article 39 includes actions or omissions that are either "wilful or

[24] Sabahi et al (n 4) 325
[25] Article 39 ARSIWA (n 7)

negligent" for the determination of contributory fault. There is no distinction made in Article 39 between wilful and negligent acts as they carry the same consequence[26]. Nor does the Article specify any qualification regarding the wilfulness or the negligence of the injured party as it will depend upon the degree to which it has contributed to the damage as well as the other circumstances of the case.

The second principle reaffirming the principle of fairness to both parties to a dispute is a substantive as much as a procedural principle. If a foreign investor has performed an act or omission that has a direct causal link to the injury suffered consequently, such an injured investor cannot be allowed to take undue benefit of such an act or omission[27]. For instance, if an injured investor performs an action that increases the quantum of losses suffered during the commission of the unlawful act by the defendant-state or after, it is not the injuring state but the investor who is responsible. In certain instances, the injured investor's actions may contribute to all of the injury incurred rather than the state. The ILC commentary notes in this regard:

> It is possible to envisage situations where the injury in question is entirely attributable to the conduct of the victim and not at all to that of the "responsible" State. Such situations are covered by the general requirement of proximate cause referred to in article 31, rather than by Article 39[28].

Thus, such instances of injury caused completely by the injured parties' own actions rather than those of the respondent-state would negate the requirement of reparation for injuries "caused" by an internationally unlawful act under Article 31. Thus, the question of the state's liability for an internationally unlawful act remains a separate inquiry. However, where any subsequent injury caused by the state's internationally unlawful act is completely attributable to the injured party and not to the state, no compensation or damages will be due. As noted by Marcoux and Bjorklund in this regard:

> The victim's contributory fault thus amounts to a circumstance that can attenuate (or even offset) compensation, without precluding the liability of the State for an internationally wrongful act[29].

The principle of fairness to both injured and injuring party in a dispute can explain the arbitral tribunals' strict avoidance of overcompensation. Without adjusting monetarily the

[26] The expression 'wilful or negligent action or omission' was taken from the Convention on the International Liability for Damage caused by Space Objects. See James Crawford, *State Responsibility: The General Part* (Cambridge University Press 2013) 501
[27] Jorge E. Viñuales, 'Defence Arguments in Investment Arbitration' (2020) 18 ICSID Reports 96
[28] Commentary to Article 39, para 5
[29] Jean-Michel Marcoux and Andrea K. Bjorklund, 'Foreign Investor's Responsibilities and Contributory Fault in Investment Arbitration' (2020) 69 International and Comparative Law Quarterly 882

consequences of the injured party's actions, the arbitral tribunal risks going beyond full compensation[30]. Considering that such compensation or damages must not exceed the loss suffered, arbitrators consider the application of the contributory fault principle as an important corrective tool against overcompensation. However, the principal challenge to such assessments is the question of quantification. How should a tribunal apportion responsibility in numeric terms? Where the tribunal finds "limited" or a "significant" degree of fault in the claimant-investor's actions leading to the injury, how does it translate these findings into adjustments in valuation? It can be argued that these questions are central to the problems of quantification in respect to investor-state arbitration. Given the increasing reliance on the contributory fault principle at the quantum stage of an arbitration and the absence of textual guidance on the matter, arbitral tribunals have sought to develop a consistent approach to the problem of quantification of acts or omissions that are held as the injured party's contributory fault[31]. Some of the inconsistencies in the approach of arbitral tribunals to contributory fault is highlighted on two aspects: *first*, in assessing the conduct of the investor, and *second*, in apportioning responsibility among the parties to the dispute.

4.1 Investor's Conduct

There is limited guidance in investment treaties regarding the assessment of the foreign investor's conduct and whether it amounts to contributory fault. Most investment treaties fail to incorporate standards of investor conduct or provide legal remedies against acts or omissions that can be construed as acts or omissions amounting to contributory fault[32]. Even though a select few BITs in recent years have strived to incorporate investor-centred obligations relating to human rights, labour and environment and other business responsibilities, they are yet to be tested out in the context of ascertaining contributory fault of investors[33]. Given the present

[30] Ibid 883
[31] Ibid 880
[32] Certain international agreements formulated in recent years have been the exceptions to the general observation. For example, the SADC Model Bilateral Investment Treaty incorporates specific obligations to observe minimum standards on human rights, environment and labour, among others. See Article 15, SADC Model Bilateral Investment Treaty Template with Commentary (July 2012). Other agreements with comparable provisions on investor obligations include Investment Cooperation and Facilitation Treaty Between the Federative Republic of Brazil and the Republic of India (signed 25 January 2020, not yet entered into force), Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria (signed 3 December 2016, not yet entered into force), the 2019 Dutch Model BIT notably incorporates obligations relating to business and human rights and business responsibilities.
[33] David Gaukrodger, 'Business Responsibilities and Investment Treaties', OECD Secretariat (2020) <https://www.oecd.org/daf/inv/investment-policy/Consultation-Paper-on-business-responsibilities-and-investment-treaties.pdf>

situation, arbitrators must rely largely on their own judgement while making determinations on whether certain actions of the investor amount to contributory fault, thereby permitting a reduction in the overall amount of compensation or damages. However, this has resulted in several inconsistencies in the assessment of investor conduct, ranging from improper application of the principle of contributory fault to instances of complete failure to apply contributory fault even where evidence of such fault has been found[34].

This seemingly discretionary approach was justified by one such ICSID tribunal in *Caratube v Kazakhstan*[35] while addressing the Respondent-state's defence on the grounds of the Claimant-investor's alleged contributory fault. With regard to the dispute that arose out of a contractual arrangement between the disputing parties, the Respondent submitted that any damages that would be awarded to the Claimant must be reduced by 50 percent due to the Claimant's contribution to its own losses for failing to perform its contractual obligations. In response, the Claimant submitted that the Respondent had failed to show that the Claimant had materially and significantly contributed to the injury and that its conduct involved a lack of due care for its own property rights[36]. The arbitral tribunal proceeded with this issue by invoking "principles of international law", which led to conclude with respect to the claimant CIOC:

> The Tribunal finds that, while it may take into account a contributory fault by CIOC in the determination of the amount of reparation to be awarded, it is entitled to wide discretionary powers in making this determination. The Tribunal further finds that it must adopt a restrictive approach in that a mere contribution to causation is not enough, in the absence of willful or negligent, reproachable behavior by CIOC, thereby materially contributing to its damage.

The tribunal here considered the determination of contributory fault as a subject of its own discretion rather than the application of any particular treaty provision or principle. As per the tribunal, international law itself permitted it to exercise its discretion in its decision-making, as per which it decided to apply the so-called 'restrictive approach'. Although the tribunal agreed with the Respondent that the contractual performance of the Claimant was 'sub-standard', the majority found that the Respondent had not established that CIOC had materially breached the contract and that the respondent had consequently terminated it on this basis[37]. The tribunal did not further elucidate on the particular international legal principles based on which it took a

[34] Marcoux and Bjorklund (n 29) 892
[35] *Caratube International Oil Company LLP and Mr. Devincci Salah Hourani v. Republic of Kazakhstan*, ICSID Case No. ARB/13/13, Award (27 September 2017)
[36] Ibid para 1190
[37] Ibid para 1193

restrictive approach to contributory fault, although the reference to Article 39 of the ARSIWA is evident in the reference to "willful or negligent" behaviour of the Claimant-investor leading to its material contribution to the damage incurred. Although the reasoning adopted by the tribunal is consistent with Article 39, its suggestion that determination of contributory fault is subject to the tribunal's discretion differs from the position taken by other tribunals[38].

4.2 Apportionment of Responsibility

The second point of inconsistency in the approach of arbitral tribunals to contributory fault is related to how tribunals allocate and quantify responsibility in specific proportions among the disputing parties. This topic has proven to be a particularly difficult problem for tribunals to solve, given that the degree of a party's responsibility is often difficult to ascertain quantitatively. For instance, let's assume the case of a host-State that has committed a regulatory action that has caused financial losses to a foreign investor. An arbitral tribunal subsequently holds the state liable for an internationally unlawful action that caused the losses to the disputing investor. However, the arbitral tribunal also agrees with the state's contention that the investor's own irresponsible financial decision-making contributed substantially to the losses incurred out of the state's actions. In is plausible in a given case that there is no method or evidentiary basis to accurately delineate the quantum of losses caused by the state's actions from those of the foreign investor's own contributory fault. Given that the fact of the foreign investor's contributory fault has already been established, a tribunal cannot refuse to account for the same without risking a subsequent challenge to the award. Therefore, any arbitral tribunal must supply a rational basis for its choice of apportionment. However, there have been persistent issues in arbitral practice regarding the manner in which apportionment of responsibility is reasoned and decided, and the role of arbitral discretion. Some of the core cases on this issue are compared below.

4.2.1 MTD v. Chile

Perhaps the most important case in the context of apportionment in terms of defining an approach for future cases was *MTD v. Chile*[39]. In this case, MTD Equity Sdn, along with its

[38] Marcoux and Bjorklund (n 29) 893
[39] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award (25 May 2004)

subsidiaries (the claimants) had filed for an arbitration against the Chilean government, the respondent state, under the Malaysia-Chile BIT of 1992. The dispute arose out of a series of foreign investment contracts signed between the claimants and the respondent for the purpose of a real estate development project[40]. The Chilean government's subsequent refusal to re-zone the project site from agricultural land led to the claim for damages arising from the capital expenditures already committed by the claimants. Among other issues, the claimants alleged that the respondent "created and encouraged strong expectations" the project on the approved site for development but later disapproved the location even though the claimant had irrevocably committed its investment. While the tribunal agreed with the claimants regarding the breach of the BIT and the subsequent damages, it sided with the respondent in agreeing to reduce the quantum of damages attributable to the claimants' business risk in Chile. The tribunal noted that the claimants "had made decisions that increased their risks in the transaction and for which they bear responsibility, regardless of the treatment given by Chile to the Claimants"[41]. On this aspect, the tribunal decided that the claimants would have to bear a 50% share of the total damages held to have been incurred after deducting the residual value of their investment. However, no explanation or reasoning was provided by the tribunal in the arbitral award for its decision to apportion responsibility for the injury on a 50-50 basis.

The respondent sought annulment of the award, particularly challenging the 50-50 apportionment on damages on grounds of (1) serious departure from a fundamental rule of procedure and (2) failure to state reasons[42]. The respondent's position was that the claimants were not liable to receive any damages at all, and the tribunal failed to state the reasons for which it had decided to reduce the award on damages by an "arbitrary and unexplained" 50 percent instead of 100 percent. Additionally, the respondent also submitted that there had been a manifest failure by the tribunal to apply the law agreed to within the BIT. It was indeterminable whether the tribunal had applied equity or other principles in making the 50 percent reduction. Therefore, the respondent argued that the award must be annulled.[43] The annulment committee agreed that there was a dearth of reasons provided by the tribunal and that some further reasons for the apportionment on a 50:50 basis could have been offered.

[40] Ibid para 54
[41] Ibid para 242
[42] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment (21 March 2007) at para 93
[43] Ibid para 98

However, the annulment committee went on to support the tribunal's decision while making some landmark observations as follows:

> As is often the case with situations of comparative fault, the role of the two parties contributing to the loss was very different and only with difficulty commensurable, and the Tribunal had a corresponding margin of estimation. Furthermore, in an investment treaty claim where contribution is relevant, the respondent's breach will normally be regulatory in character, whereas the claimant's conduct will be different, a failure to safeguard its own interests rather than a breach of any duty owed to the host State. In such circumstances, it is not unusual for the loss to be shared equally. International tribunals which have reached this point have often not given any "exact explanation" of the calculations involved. In the event, the Tribunal having analysed at some length the failings of the two parties, there was little more to be said - and no annullable error in not saying it. [44] (emphasis added)

On the basis of these findings and the fact that the arbitral tribunal had analysed the findings of both parties, the annulment committee decided not to grant annulment of the award on the grounds raised by the respondent. Considering the importance of this particular passage in the subsequent practice of arbitral tribunals, it would be useful to further examine the annulment committee's decision. The respondent's first argument for annulment was based on the reason that the arbitral tribunal had failed to state reasons for its decision to apportion only 50 percent of the damages. The failure to state reasons that form the basis of an award is a permissible ground for seeking annulment of an ICSID arbitral award under Article 52(1)(e) of the ICSID Convention. The annulment committee even agreed that some further reasons to explain the 50-50 split could have been offered by the tribunal. However, the annulment committee seemingly steps in at this juncture to interpret the reasoning that could have been applied by the claimant-investor: (1) the difficulty in measuring the role of the disputing parties' contributions to the losses in the instant case, and (2) the tribunal's corresponding margin of estimation, which is nothing but the power of the arbitral tribunal to exercise its discretion. The annulment committee was effectively affirming the arbitral tribunal's discretion to decide on how the apportionment of responsibility should have taken place, given the difficulties involved in quantifying contributory fault. This has also been accepted as the annulment committee's position by much of the scholarly work on contributory fault in investor-state arbitration[45], as well as subsequent arbitral tribunals that we will examine below. The idea that difficulties in

[44] Ibid para 101

[45] Mark Kantor, 'The Impact of Contributory Investor Conduct: Only with Difficulty Commensurable' in Meg Kinnear, Geraldine R. Fischer (eds), *Building International Investment Law: The First 50 Years of ICSID*, Kluwer Law International (2015) 533

calculation or commensuration is connected with a "corresponding margin of discretion", as described by the MTD tribunal, has also been noted earlier regarding the tribunal's decision making on choice of valuation methods, determination of lost profits, among others. Providing arbitral tribunals with a 'margin of estimation' allows them to decide on some form of apportionment that is particularly useful in cases where the precise quantification of contributory fault may be difficult to ascertain. This conception of arbitral discretion was developed further by the arbitral tribunals in the case of *Occidental v. Ecuador* and the connected matters in *Hulley v. Russia*, *YUL v. Russia*, and *VPL v. Russia* (*Yukos* awards). The findings of the tribunal regarding arbitral discretion and the apportionment of responsibility add further to the conception of arbitral discretion in *MTD v. Chile.*

4.2.2 Occidental v. Ecuador

The *Occidental v. Ecuador* arbitration arose in the context of a participation contract for the exploration and development of petroleum deposits that was signed in 1999 between Occidental Petroleum Corporation (OPC), Occidental Exploration and Production Company (OEPC), together referred to as claimant-investors, with the government of the Republic of Ecuador (respondent-state)[46]. The claimants subsequently signed a 'farmout' agreement in 2000 with Alberta Energy Corporation Limited (AEC), by the terms of which AEC would partially finance the claimants' operations in lieu of a 40% economic interest in 'Block 15', which was the subject of the participation contract between the claimants and the respondent state. This transfer was alleged by the respondent and affirmed by the ICSID tribunal to be violative of the participation contract and Ecuadorian law due to the lack of ministerial approval. Following an audit of OEPC in 2004 and subsequent political pressure, including strikes and demonstrations against OEPC, the government of Ecuador issued a *caducidad* decree. The decree terminated the participation contract between the two parties and ordered OEPC to turn over all of its assets relating to Block 15.

In the ICSID arbitration launched by the claimants under the 1993 United States-Ecuador BIT, the arbitral tribunal agreed that the claimant-investors were in violation of the participation contract and Ecuadorian law due to their failure to gain ministerial approval for the farmout agreement. However, the tribunal also held that the termination of the participation contract to

[46] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012)

be a *disproportionate* response to the claimants' failures in seeking ministerial approval. The respondent's *caducidad* decree was held by the tribunal as a remedy of last resort and that there were adequate alternatives available, including settlement. Having found the *caducidad* decree as a disproportionate response as a breach of Ecuadorian law, breach of the fair and equitable treatment provision of the BIT and breach of customary international law. In its decision on quantum, the tribunal accepted the respondent's submission regarding the need for reduction of the amount of damages arising out of the claimants' contributory fault.

Referring to the *MTD v Chile* award, the tribunal noted that any contribution of the injured party to its losses must be "material and significant" and that the tribunal has a "wide margin of discretion in apportioning fault"[47]. Having found that the claimants had agreed to a contractual framework which had the risk of the *caducidad* decree being issued for their failure to get the necessary ministerial approval, the tribunal expressed its views on its discretion to reduce compensation in following terms:

> The Tribunal agrees that an award of damages may be reduced if the claiming party also committed a fault which contributed to the prejudice it suffered and for which the trier of facts, in the exercise of its discretion, considers the claiming party should bear some responsibility[48].

Having already found that the claimant had committed an unlawful act by failing to obtain prior ministerial approval for the farmout contract knowing the risks involved, the tribunal decided that the claimant must "pay a price"[49]. In considering the question of apportionment, the tribunal first expressed its agreement with the ICSID annulment committee's observations in *MTD v. Chile* that the role of the two parties contributing to the loss is commensurable only with some difficulty and consequently, the Tribunal has a margin of estimation. On this basis, the tribunal referred to its discretion in finding that the claimants had contributed 25% of the losses suffered when the respondent-state issued the *caducidad*. The tribunal considered this scheme of apportionment to be fair and reasonable to both parties. Thus, in a manner similar to the *MTD v. Chile* decision, the arbitral tribunal here made use of its discretion to apportion responsibility between the parties. The majority tribunal did not provide any additional reasons for the specific percentages of apportionment or engage in an assessment of proportionality as it had done while determining liability. The tribunal's decision-making it seems that as long as it is

[47] Ibid para 670
[48] Ibid para 678
[49] Ibid para 680

satisfied that a specific structure of apportionment is fair and reasonable, the tribunal has dispensed with its responsibility to reduce damages based on contributory fault.

The apportionment as determined by the majority tribunal in *Occidental v. Ecuador* was criticised by its member-arbitrator Brigitte Stern, who addressed the issue in her dissenting opinion[50]. Stern's broader dissent regarding the manner in which damages were determined by the majority tribunal included her disagreement with the tribunal's ascertainment of a 25-75 split in the claimants' favour. Stern was of the opinion that the tribunal's consideration of the claimants' fault was "overly underestimated and insufficiently taking into account the importance that each and every State assigns to the respect of its legal order by foreign companies"[51]. According to Stern, the claimants' deliberately took the risk of the *caducidad* decree by their actions, and it was more likely than not going to happen due to these actions considering Ecuadorian law and the reference to *caducidad* in the participation contract. Stern contrasted the present case with the *MTD v. Chile* award and the subsequent annulment committee's decision, where the 50-50 apportionment was decided on the basis of the claimants' fault in the form of an imprudent business decision rather than any form of illegality. Therefore, Stern felt that a 50-50 split would have been even more justified in the present case, given that the claimants were in breach of Ecuadorian law.

Interestingly, arbitrator Stern qualified her opinion regarding this issue by stating that she did not think that the majority tribunal's decision was not based on an error of law or an excess of power but "on a different appreciation of the factual situation, which is at the discretion of the Tribunal."[52] She did not, however, provide any further explanation as to the particular fact issues over which this difference in appreciation arose, or its relevance to the 25-75 apportionment for contributory fault. The absence of any further discussion on this issue in the dissenting opinion means that the difference in reasoning between the majority and Stern cannot be fully examined beyond what was already stated. Although Stern drew attention to how an unlawful act in *Occidental* still resulted in a more favourable apportionment for the claimants than a bad business decision in *MTD*, there was no deeper examination of how such apportionment should be done. Further, Stern did not specifically address the majority's reasoning (or the lack thereof) but instead ascribed her difference with the majority as a matter of difference in the appreciation of facts. Without terming the tribunal's reasoning and decision

[50] Brigitte Stern, Dissenting Opinion, *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11 (20 September 2012)
[51] Ibid para 4
[52] Ibid para 7

as erroneous, Stern suggested that the majority tribunal did not place enough emphasis on the gravity of the claimants' breach of the participation contract and Ecuadorian law. However, she defended the majority tribunal's differing approach as a part of its discretion in the appreciation of the factual situation of a case.

Although the award was subjected to ICSID annulment proceedings filed by the respondent-state Ecuador, unlike the *MTD v. Chile* annulment process, no challenges were raised against the specific scheme applied by the arbitral tribunal for apportionment of responsibility[53]. In fact, the *Occidental v. Ecuador* award was influential in the decision-making process regarding contributory fault for subsequent tribunals. It may be stated that the *MTD* and *Occidental* cases established the line of arbitral jurisprudence regarding apportionment of responsibility and overall quantification of contributory fault that continues to be referred until today. As we will see with the *Yukos* awards, both of these awards helped cement the notion of "wide discretion" of arbitral awards that applied particularly to the task of apportionment but also more generally to an arbitral tribunal's power to reduce the amount of compensation or damages where contributory fault has been established.

4.2.3 Yukos awards

The 2014 arbitral awards issued in the case involving the principal shareholders of OAO Yukos Oil Company against Russia made waves internationally for awarding a record amount of over 50 billion USD in compensation and damages against a party in international arbitral proceedings. The awards in the three parallel arbitral proceedings, referred here jointly as the *Yukos* awards[54], crystallised the principles governing contributory fault and its resultant apportionment of responsibility from the earlier *MTD v. Chile* and *Occidental v. Ecuador* awards. For the sake of brevity and simplicity, the extracts from the *Yukos Universal Limited (Isle of Man) v. The Russian Federation* award are presented below and used in reference to the *Yukos* dispute/*Yukos* awards.

[53] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Decision on Annulment (2 November 2015)

[54] *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 227, Final Award, (July 18, 2014) ("*Yukos*"); *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 226, Final Award, (July 18, 2014) ("*Hulley*"); *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL (ECT), PCA Case No. AA 228, Final Award (July 18, 2014) ("*Veteran*"). Given the common factual and legal issues and the largely identical award issued by the same tribunal in all three awards, the references presented here are from the *Yukos* award. Both *Hulley* and *Veteran* also contain the identical discussion.

The *Yukos* dispute comprises of a complex series of fact patterns with events ranging over a period of several years but can be summarised as a dispute regarding unlawful expropriation of the Yukos Oil Company (or 'Yukos') by the Russian government and its failure to protect the claimant-investors' investments in Yukos, resulting in enormous financial losses. The arbitration was filed under the dispute settlement provision of the Energy Charter Treaty (ECT) to which Russia was a signatory[55]. Yukos had been operating as a vertically integrated petroleum group in Russia that had been fully privatised in the 1990s. By 2002, it had become the largest producer of oil in Russia in term of daily crude production[56]. The host of measures taken by the Russian government allegedly included criminal prosecution, harassment, tax reassessments, fines, asset freezes, and the forced sale of Yukos' main oil production asset, Yuganskneftgaz (YNG)[57]. The claimant-investors had alleged that these varied measures had occurred between July 2003 and November 2007 resulting in unlawful expropriation of property[58] as well as a breach of fair and equitable treatment as protected under the ECT[59]. For these varied breaches, the three shareholders in their claims sought full reparation to the amount of 114 billion USD that was to be divided proportionately in terms of their respective shareholding in Yukos.

Without engaging in an analysis of the arbitral tribunal's reasoning, it is sufficient to state here that the tribunal agreed to the breaches alleged by the claimant-investors and held Russia liable for the same. On the issue of quantum, the tribunal calculated damages amounting to USD 50.02 billion, which reflected the equity value of Yukos and dividends payable as on the tribunal's choice of valuation date 30 June 2014, i.e. the date of the award[60]. This sum of damages was reached after a reduction of 29.5 percent was applied to the total equity value of the company to reflect the total shareholding of the three claimant-investors, followed by a 25 percent reduction of value due to the claimant-investors' contributory fault. This 25 percent reduction was based on the arbitral tribunal's decision to apportion responsibility on a 25-75 basis on the findings of a series of actions by the claimant-investors that was held to constitute contributory fault[61].

[55] The Energy Charter Treaty (adopted in Lisbon on 17 December 1994)
[56] Mark Kantor, 'Fifty Billion Dollars: The Yukos Damages Awards' (2015) 2 Journal of Damages in International Arbitration 1. 91
[57] Judith Gill and Rishab Gupta, 'The Principle of Contributory Fault after Yukos' (2015) 9 Dispute Resolution International 93
[58] Article 13(1) of the ECT (n 55)
[59] Article 10(1) of the ECT (n 55)
[60] *Yukos* award (n 54) para 1769
[61] Ibid para 1607

In its analysis, the arbitral tribunal first elected to categorise contributory fault into two types: (1) where the contributory fault of the investor, while it may have increased the loss which it sustained, was unrelated to the wrongdoing of the State (2) where the tribunals found that the victim contributed to the State's wrongful conduct[62]. Tribunal considered the case of *MTD v. Chile* as one belonging to the first category, given that the claimants' contributory fault, though prejudicial to its own interests, did not affect Chilean government's unlawful actions. This was in contrast to the *Occidental v. Ecuador* case, where the claimants' breach of contract led to the issuance of the *caducidad* decree by the Ecuadorian government and could thus be considered as a case belonging to the second category. The tribunal then proceeded to consider a host of allegations of misconduct that had been raised by the respondent-state Russia, in order to determine which of them could constitute an act of contributory fault. Among these instances, the tribunal determined that the claimant-investor's tax avoidance arrangements in certain low-tax regions of Russia made it possible for respondent to invoke and rely on that conduct as a justification of its actions. The tribunal observed in this regard that even though the Russian government had taken various measures to harm the claimant's measures as opposed to just collecting the taxes that might have been assessed correctly and legitimately against the trading companies on the basis of the "bad faith taxpayer" doctrine, there is a sufficient causal link between Yukos' abuse of the taxation rules in some of the low-tax regions and its subsequent downfall. Therefore, this led to a finding of contributory fault on the part of Yukos[63].

Having rejected the respondent's contentions on the other forms of alleged misconduct by the claimant-investors, the arbitral tribunal moved on to the task of apportionment. Here, the tribunal affirmed the observations of the *MTD* annulment committee and the *Occidental* tribunal on the need for the claimants' to bear a certain degree of responsibility for their actions. It quoted the MTD annulment committee's observations regarding the difficulties in commensuration of loss caused by contributory actions and the corresponding margin of estimation given to tribunals. Further, it held as follows:

> the Tribunal, in the exercise of its wide discretion, finds that, as a result of the material and significant mis-conduct by Claimants and by Yukos (which they controlled), Claimants have contributed to the extent of 25 percent to the prejudice which they suffered as a result of Respondent's destruction of Yukos. The resulting apportionment of responsibility as between

[62] Ibid para 1605
[63] Ibid para 1615

> Claimants and Respondent, namely 25 percent and 75 percent, is fair and reasonable in the circumstances of the present case[64].

It is immediately evident that this decision on apportionment by the arbitral tribunal is largely identical to the decision of the *Occidental* tribunal, which had also considered a 25-75 apportionment to be fair and reasonable given the circumstances of the case. As with the *Occidental* award, the *Yukos* tribunal too invoked the difficulties of commensuration of contributory fault and the margin of estimation, or its discretion, as justifications for its eventual decision on apportionment. Most importantly, neither of these tribunals elected to discuss or provide reasons as to *why* they considered the commensuration of contributory fault to be difficult in their respective cases because of which they were exercising their discretion. The *MTD* annulment committee provided some justification for a 50-50 apportionment of the responsibility for losses based on the nature of the claimants' and respondent's actions in that particular case and the fact that it was not unusual in such cases for the loss to be shared equally. However, both *Occidental* and *Yukos* tribunals elected to refer to only the first part of the paragraph from the *MTD* annulment committee's decision. The *Yukos* tribunal, despite its relatively detailed discussion on contributory fault and the two categories fault that it had identified, chose not to detail the consequences of these findings on the issue of apportionment. Like the *Occidental* award, the tribunal seems to have satisfied itself with what it found to be fair and reasonable on the basis of its own "wide discretion".

Although the basis of apportionment applied by the tribunals in these cases may seem inconsequential at first glance, the sheer effects on quantum of compensation that such decisions may have cannot be underestimated. In the *Occidental* award, the tribunal's decision to assign 25% of the responsibility on the claimants' resulted in about 590 million USD of reduction in the overall sum of damages, which was an amount larger than the quantum awarded in all but a handful of awards until then[65]. If arbitrator Stern's arguments in her dissenting opinion had been followed and the apportionment was done on a 50-50 basis, then the reduction would have amounted to approximately 1.18 billion USD out of the total damages that would have had to be paid by the respondent. Similarly, the reduction in damages arising from apportionment of 25% of the responsibility for losses on the claimant-investors in *Yukos* amounted to approximately 16 billion USD[66]. This vast sum in itself is larger than the *total*

[64] Ibid para 1637
[65] Sabahi (n 5) 289
[66] Borzu Sabahi and Diora Ziyaeva, 'Yukos v. Russian Federation: Observations on the Tribunal's Ruling on Damages', (2015) 12 Transnational Dispute Management Journal 5, 20

compensation or damages in any known investor-state arbitration till date but would have been considerably larger if the tribunal had decided that say a 30-70 or 50-50 apportionment would have been fair and reasonable.

4.2.4 Subsequent Arbitral Practice

The three awards discussed so far have been central to the development of arbitral practice regarding apportionment of responsibility that arise from contributory fault. Each case has helped shape to a certain degree what can be considered as settled position on the subject of contributory fault. The *MTD v. Chile* decision on annulment firmly established the idea regarding the inherent difficulties in quantifying contributory fault of parties and the corresponding margin of estimation of the arbitral tribunal that must be respected by other tribunals and annulment committees. The decision also set the broader contours for situations where arbitral tribunals might choose to apportion loss equally among the disputing parties. In the specific case, the committee considered the state's fault in terms of unlawful regulatory action and the claimants' fault in the form of failure to make better business decisions (but not amounting to a legal liability). The tribunal's observation regarding such decisions lacking exact explanations would also be important. The *Occidental v. Ecuador* award contributed to the understanding of "causation" and "materiality" as key considerations for findings of contributory fault, in terms of Article 31 and 39 of the ARSIWA[67]. Further, the award affirmed the principle of "wide discretion" in context to the tribunal's decision to apportion some responsibility for contributory fault as well as in determining the basis for such apportionment. This was followed by the *Yukos* arbitral awards, where the arbitral tribunal further affirmed the respective positions taken in *MTD* and *Occidental*, while providing a classification of actions that amount to contributory fault. In subsequent arbitral awards where the contributory fault was raised as a defence, notions such as the tribunal's discretion would inadvertently be drawn from this jurisprudence. A few examples are briefly discussed below.

In *Copper Mesa v. Ecuador*, the respondent-state had raised objections against the claimant being compensated for losses incurred against certain concessions, which the respondent alleged was acquired by fraudulent means[68]. Though the respondent in the case had separately raised the grounds of causation, unclean hands and contributory fault in its defence arguments,

[67] Kantor (n 45) 552
[68] *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA No. 2012-2, Award (15 March 2016) para 6.4

the tribunal was of the opinion that there was a common approach to resolving disputes for all three grounds[69], namely under Article 39 of the ARSIWA, which has already been discussed earlier. The tribunal was of the view that the determination of contributory fault under Article 39 was a question requiring factual assessment of the claimant's conduct, thereby proceeding to examine the relevant facts. Consequently, having decided that the claimant was indeed liable for its conduct leading to its losses, the tribunal determined the claimant's contribution at 30 percent, regarding which it observed that based on the facts of the case, the contribution "could not be less"[70]. This determination of contributory fault based on factual assessment can be contrasted with the approach in *Occidental v. Ecuador* and *Caratube v. Kazakhstan*, where such determination was considered by the tribunals to be made on the basis of discretion. However, it seems that even the *Copper Mesa* tribunal has taken the same approach as the others in apportioning responsibility on a discretionary basis considering that the tribunal did not explain why the claimant's contribution should not be less than 30 percent.

Some more recent tribunals have continued to decide on issues of contributory fault in a manner similar to *MTD* and *Occidental.* In *UAB Energija v. Latvia*, the arbitral tribunal had reduced the damages by 50% in order to account for the claimants' contributory fault[71]. The tribunal had found that the claimant had suffered losses due to its own decision to stop paying the full price for natural gas purchased, leading to the revocation of licences by the respondent-state's regulatory authority. The tribunal also stated that its examination of the evidence stated its position as follows:

> Having weighed all the evidence examined in the present Award, the Tribunal finds that the Claimant and the Respondent have contributed to the losses suffered by the Claimant to an extent that is, all in all, broadly equivalent and that the Claimant should therefore be awarded 50% of the actual losses mentioned above[72].

The award was brought by respondent-state Latvia to ICSID annulment proceedings, where the annulment committee had to consider *inter alia* whether the arbitral tribunal had failed to state reasons for its decision to split the damages equally. The respondent argued that the tribunal had engaged in an "arbitrary baby-splitting exercise" by agreeing to award 50 percent of the

[69] Ibid para 6.97
[70] Ibid para 6.102
[71] *UAB Energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award (22 December 2017) para 1143
[72] Ibid para 1144.

damages claimed[73]. Further, the respondent-state had argued that the arbitral tribunal had failed to identify the law on causation and without explaining what evidence it relied on and why it was relevant. Though the annulment committee agreed that the arbitral tribunals have provided more reasons regarding its finding on contributory loss, it held that the arbitral tribunal had "already examined the evidence on the record, including the expert evidence in detail, and had considered whether damages should be awarded under international law and the BIT"[74].

The annulment committee went on to refer to some of the observations made by the arbitral tribunal regarding the respective causes for the loss that had occurred out of the actions of both parties. Moving further to the question of apportionment, the annulment committee affirmed the *MTD v. Chile* decision on annulment by quoting the entire paragraph already discussed earlier[75]. Therefore, the annulment committee in *UAB Energija v. Latvia* followed the *MTD* annulment committee's decision regarding the difficulties in commensuration and corresponding margin of estimation. The tribunal agreed with the *MTD* position that in cases where tribunals have apportioned damages equally, an 'exact explanation' is not always possible. However, this fact in itself does not create grounds for annulment for failure to state reasons. Consequently, the annulment committee decided that the explanation given by the *UAB Energija v. Latvia* for a 50-50 apportionment was adequate and the award could not be annulled for failure to state reasons.

Arbitral practice has thus, largely crystallised on the related issues of determining contributory fault and its apportionment, though some divergences continue to exist, such as whether such decisions are subject to assessment the facts of the case or arbitral discretion. In cases where arbitral tribunals choose to apportion responsibility on an equitable basis, they usually refer to the *MTD v. Chile* annulment decision in support of their position. Where the apportionment is of another form, whether 30-70, 25-75 or others, there is generally a direct reference to *Occidental v. Ecuador* and similar awards[76].

[73] *UAB Energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Decision on Annulment (8 April 2020) para 194
[74] Ibid para 195
[75] Ibid para 197
[76] See for instance, *STEAG GmbH v. Kingdom of Spain*, ICSID Case No. ARB/15/4, Award (8 September 2020) para 798

4.2.5 Critical Appraisal

Scholarly criticism regarding the largely tribunal-led practice of ascertaining and apportioning responsibility for contributory fault has centred around two issues: *first*, the wide scope of arbitral discretion in apportioning damages allows tribunals to make decisions that are lacking or inadequate in terms of reasons for apportionment[77]. Recent scholarly criticism on apportionment of damages has focussed on the problem of inadequacy of reasons that accompany a decision on specific apportionment of losses, making it difficult to determine the basis for such apportionment[78]. *Second*, the exercise of arbitral discretion may allow considerations of equity rather than the fact patterns or legal principles to determine the apportionment of losses. The following discussion will therefore be concerned with a critical perspective on the effects of arbitral discretion and the specific problems that have arisen, including the role of equity.

A. Inadequate Reasoning

The idea of arbitral discretion in the apportionment of damages arose with the ICISID annulment committee's decision in *MTD v. Chile*. As already examined earlier, the annulment committee found that arbitral tribunals indeed have a "margin of estimation" that naturally arose out of the difficulties associated in quantifying actions amounting to contributory fault. However, if older awards are examined where reduction in damages were allowed, there were no references to such margin of estimation regarding the tribunal's decision-making. For example, in the *Delagoa Bay Railway* arbitration, the arbitral tribunal held that an injured party's actions or omissions contributing to its losses could be considered as "extenuating circumstances" alleviating government liability and warranting a reduction in the amount of damages[79]. Even in cases contemporary to the *MTD v. Chile* award, the basis for adjustments in damages due to contributory fault were not generally explained. For instance, in *Bogdanov v. Moldova*, the arbitral tribunal decided that the claimant-investor was held partly responsible for its losses due to the claimant's failure to include a particular clause regarding compensation

[77] JF Merizalde Urdaneta, 'Proportionality, Contributory Negligence and Other Equity Considerations in Investment Arbitration', in Ian A. Laird et al. (eds.), *Investment Treaty Arbitration and International Law* (JurisNet 2015) See also in the same volume, Meriam N. Alrashid, The Arbitral Tribunal's Discretion in Quantifying Damages (2015) 327-353

[78] Marcoux and Bjorklund (n 29) 20-21

[79] *United States and Great Britain v. Portugal (Delagoa Bay Railway)* (1902) quoted in Marjorie Whiteman, *Damages in International Law (*U.S. Government Print off 1937) 206.

in its privatization contract with the respondent-state[80]. Consequently, the awarded damages were halved on the basis of a 50-50 apportionment of losses. Even the *MTD v. Chile* arbitral tribunal did not make any reference to its discretion. Rather, the tribunal determined that the claimants had to bear part of the damages suffered and 'estimated' this share at 50 percent[81]. It is likely that the subsequent annulment committee's use of the term "margin of estimation" was derived from the arbitral tribunal's words "the Tribunal estimates its share to be 50%".

The annulment committee noted that the tribunal had held the contributory fault to be material and significant based on a factual assessment of the case[82]. The committee did not comment on the merits of the tribunal's decision to split responsibility evenly but recognised a margin of estimation to exist where (1) the role of the parties' contribution to the loss is different (e.g. regulatory act viz-a-viz poor business decision) and (2) such contributory actions were difficult to commensurate.

It was the *Occidental v. Ecuador* award that further crystallised the idea of "margin of estimation" as given in the *MTD* annulment decision but by paraphrasing it with the term "wide discretion" of arbitral tribunals in apportioning fault[83]. The import of this wide discretion, according to the tribunal, is twofold. First, if a tribunal found that an injured party's contributory fault was material and significant, it would be up to the tribunal's discretion to make the injured party bear responsibility for the said contributory fault[84]. Second, the apportionment of this responsibility would also be up to the arbitral tribunal's discretion. While the first aspect is a necessary consequence of the principle of contributory fault and its ascertainment under Article 39 of the ARSIWA, it is the exercise of discretion under the second aspect – the apportionment of responsibility – that has proven to be a contentious issue, particularly given that some tribunals have fallen short of giving reasons for the same[85]. The manner in which the issue of apportionment was decided in *Occidental* and *Yukos* awards presents some interesting points of discussion in this respect.

If the part of the *Occidental* award where the apportionment of contributory fault is examined, the thinness of reasoning applied by the tribunal becomes quite apparent. Here, the tribunal

[80] *Iurii Bogdanov, Agurdino-Invest Ltd. and Agurdino-Chimia JSC v. Republic of Moldova*, SCC Award (22 September 2005)
[81] *MTD v. Chile* (n 39) para 224.
[82] *MTD v. Chile* Decision on Annulment (n 42) para 101
[83] *Occidental v. Ecuador* (n 46) 670
[84] Ibid para 671.
[85] Sean Stephenson, 'Quantum and Reasons in Investment Treaty Arbitration: The Next Reasoning Frontier?' (2021) ICSID Review 1

began with a description of the contributory acts of both claimants' and their respondent-state to the losses that occurred[86]. In four short paragraphs, the tribunal determined that (1) the totality of the claimant's damages arose out of the Ecuadorian government's *caducidad* decree, and (2) besides the contractual and legal violation by claimant OEPC, a separate VAT award and social unrest directed against OEPC also contributed to the *caducidad*. However, after having decided on these factors as complimentary factors behind the *caducidad*, the tribunal observed that measuring the weight of the individual causes along the causal chain that led to the issuance of the *caducidad*[87]. The tribunal did not explain why the task of weighing the causal link was difficult, or the possible difficulties that it would face in the process. There were no discussions either in terms of the party's submissions on the issue, or the tribunal's own reasons for reaching this conclusion. Instead the tribunal connected this finding on difficulty of quantifying causal impact with the *MTD* annulment committee's position regarding the difficulties in quantifying the role of the parties in assessing contributory fault.

It is evident that the *MTD* annulment committee's observations were only with respect to the case at hand, and were no intended to be applied generally, even though it observed that difficulty of measurement is "often" the case where comparative fault is applied. While the *MTD* annulment committee sought to explain the tribunal's apportionment on a 50-50 basis as common practice among adjudicatory bodies in dealing with actions that are different in nature, there is no similar reasoning by the *Occidental* tribunal on why 25-75 per cent apportionment was appropriate in the case. The tribunal here simply referred to its discretion while stating its decision on the issue, and that such apportionment was "fair and reasonable" in the particular circumstances of the case[88]. While the *Occidental* tribunal clearly sought to cast its decision along the lines of the *MTD* annulment decision, it was quite clearly deficient in terms of reasoning even in comparison to the minimal reasoning applied by the *MTD* committee. Arbitrator Stern's dissenting opinion is also relevant here, although her argument was not regarding the inadequacy of the reasoning in itself, but rather the difference in the appreciation of facts. Stern's contention that the apportionment should have been based on a 50-50 basis is also indicative of the degree of discretion that the arbitrators had assumed in the case, considering how Stern sees no other factor other than the appreciation of facts as to why a 50 percent apportionment should not be preferred.

[86] *Occidental v. Ecuador* (n 46) para 681
[87] Ibid para 685
[88] Ibid para 687

Commentators have characterised the apportionment in *Occidental* as well as the similarly decided *Yukos* award as a tendency of tribunals to take a "broad-brush" approach rather than any attempt to calculate the financial impact of the assumption of risks for which the tribunal concluded the claimants should bear responsibility[89]. By expressly invoking discretion at the stage of apportionment, *Occidental* and other subsequent tribunals have avoided giving clear reasons or explanations for preferring a specific basis of apportionment over others. Similar issues are also evident in the *Copper Mesa v. Ecuador* (30-70 apportionment), *STEAG GmbH v. Kingdom of Spain* (25-75 apportionment), *UAB Energija v. Latvia* (50-50 apportionment), among others, where the structure of analysis by the tribunal begins with a factual assessment of the contributory actions of the parties followed by apportionment with reference to the tribunal's discretion. The approach taken by arbitral tribunals at this stage may be contrasted with the general assessment of compensation and damages done for the claimant's position, where the financial impact of each unlawful state action is considered with the application of a specific basis and method of valuation. Though the necessity of discretion is itself undeniable, given that contributory causes are not as easily measurable or proven according to an established standard of proof, the absence of cogent reasons opens the door for tribunals to make decisions that may not reflect the realities of the case nor provide the parties to seek remedies against the arbitral award by means of annulment or set-aside proceedings.

Due to the tendency of arbitral tribunals and annulment committee's to give deference to discretionary decision-making, apportionments made on the basis of discretion may largely go unaddressed. This was the case in the respective annulment proceedings in *MTD v. Chile* and *UAB Energija v. Latvia*, where the arbitral tribunal was satisfied with the findings on facts made by the arbitral tribunals as adequate for the purpose of deciding the scheme of apportionment for contributory fault. There is thus very little explanation given by tribunals beyond the statement that a specific apportionment is 'fair and reasonable' or that 'it could not be less'. However, the reference to arbitral discretion does not prevent tribunals from providing a justification of the manner in which this discretion is exercised. Despite the understandable issues in providing a mathematically precise answer, tribunals still need to provide some form of explanation for their decision[90].

The problem of calculating contributory fault with 'mathematical precision' is difficult, and as seen in the practice in many common law jurisdictions, judges frequently resort to awarding by

[89] Gill and Gupta (n 57) 93
[90] Marcoux and Bjorklund (n 29) 899

percentages than attempting to take any scientific approach to quantification[91]. While certain issues governed by statutory rules regarding compensation and apportionment of losses may apply, the norm among many domestic courts is generally directed by a discretionary approach[92]. But regardless of the difficulties of finding accurate values or proportions, where arbitral tribunals have the option to evaluate contributory actions in terms of their financial impact, it is argued that they should not be avoided by resorting to discretion. For instance, effects of sales and purchases, breach of contracts, avoidance of tax liability, committing actions punishable in terms of penalties or fines etc. are some forms of actions that can be quantitatively ascertained more easily than others. Commentators have noted how the claimant-investors' contributory fault in avoiding taxes in the *Yukos* awards as one such instance where the amount of of the taxes avoided by the petroleum company was readily available to the tribunal. However, the tribunal chose to proceed with its approach of apportioning responsibility arising on the basis of tax avoidance schemes of the claimant-investors on a discretionary basis[93].

B. Equitable Considerations

The current practice of arbitral tribunals in making discretion-based quantification of contributory fault opens the way for equitable considerations to enter the decision-making process. As noted earlier in Chapters 2 and 3, arbitral tribunals tend to rely on equitable considerations when faced with difficult choices in making decisions on a range of issues related to substantive and procedural rights. This is particularly acute in arbitral choices regarding valuation criteria and methods. Similarly, equitable considerations tend to play an important role when tribunals tend to lean on discretion in resolving problems of contributory fault. Particularly where there are no express principles guiding the process of adjustments for the individual responsibilities of parties, as is largely the case for contributory fault, tribunals tend to rely on equity *praeter legem* in order to reach an outcome in the form of a final award[94]. Equity may factor into an award of damages either in the form of considerations of equity (as a general principle of law) or more specifically as an award made *ex aequo et bono* on the basis

[91] Gill and Gupta (n 57) 112
[92] James Goudkamp, 'Apportionment of Damages for Contributory Negligence: A Fixed or Discretionary Approach?' (2015) 35 Legal Studies, 1, 621–647
[93] Gill and Gupta (n 57) 113
[94] Enrico Milano, 'General Principles Infra, Praeter, Contra Legem? The Role of Equity in Determining Reparation' in Mads Andenas et al. (eds), *General Principles and the Coherence of International Law* (Brill 2019)

of prior agreement of the parties to the arbitral process[95]. Arbitral tribunals may expressly admit that they have based their decisions on equitable considerations in the award, or it may be reflected indirectly in the language implying such considerations[96]. The *MTD* annulment committee's decision can be considered as one such instance of the latter, particularly where it contrasted the claimant's poor business decisions with the unlawful regulatory actions by the respondent state.[97]

According to the annulment committee, where there is a difference in the forms of actions contributing to the losses incurred by the injured party, there is a tendency in international judicial practice to prefer the sharing of losses on an equitable basis. In *CMS v. Argentina*, which involved claims arising from losses caused by certain state measures during the Argentinian financial crisis, a similar reference to equitable considerations arising from inherent business risk of operating in the country was referred to[98]. It has also been noted earlier how in certain arbitral awards like *UAB Energija v. Latvia* and *Bogdanov v. Moldova*, the arbitral tribunals have decided to let the parties share losses equally where the nature of each party's contributory fault is similarly situated, i.e. the state has committed a breach of law, while the injured party has either made poor business decision or failed to act responsibly.

Despite the ubiquity of equity-based discretion at the stage of consideration of contributory fault, the principal issue involved in the exercise of discretion lies with respect to process. This refers to the indeterminacy of the ways in which arbitral tribunals reach a decision when exercising equity-based discretion is the chief issue of concern. This may also go on to have an effect on outcome, where a series of awards with no clear reasoning regarding quantification of contributory fault and with divergent opinions on the desirable basis of apportionment covering similar fact patterns may result in lack of consistency and coherence in terms of arbitral jurisprudence[99].

The problem of process in exercise of equity-based discretion is largely connected to the problem of inadequate reasons as discussed earlier. Where tribunals have exercised discretion in deciding to apportion responsibility for losses equally, there is minimal or no reasoning as to why an equal apportionment is suitable. As seen above in the *MTD* annulment decision, the

[95] For a discussion on the differences between equitable considerations and *ex aequo et bono* decisions, see Chapter 2, Section 4.1.2.
[96] Borzu Sabahi et al (n 2) 729
[97] *MTD v. Chile*, Decision on Annulment (n 42) para 101
[98] *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (12 May 2005) para 248
[99] Marcoux and Bjorklund (n 29) 880

annulment committee having failed to locate any reasons in the arbitral award proceeded to providing its own explanation as to why an equal apportionment was appropriate. The committee not only accepted the that the arbitral tribunal had a margin of estimation, but also indicated that general practice of tribunals is to split the losses equally in cases where the claimant and the respondent's conduct are different in nature[100]. Considering apportionment as a purely discretionary exercise, the arbitral tribunals have accordingly proceeded to make specific apportionments as noted above based on broad notions of fairness and reasonableness, which are the constitutive elements of equity. As Catharine Titi observes:

> What is equitable must be reasonable and, conversely, what is unreasonable can only be inequitable. The close ties between equity and reasonableness – but also between reasonableness and two other equitable principles, good faith and proportionality – are frequently acknowledged.[101]

It is in this particular adherence to equity-based discretion according to which arbitral tribunals arrive at a particular apportionment. The analysis in most awards comprises of a re-statement of the facts that are relevant to the apportionment, including the impugned actions of both claimant and respondent. This is followed by a finding that a certain action or omissions was substantial in terms of its effects on the subsequent losses that occurred. There is generally no effort to quantify the effects of such actions, which may be explained by the fact that disputing parties also rarely seek specific apportionments or adduce evidence in support of a specific apportionment of losses. For instance, the respondent-state in *Occidental v. Ecuador* submitted that "any damages awarded to the Claimants should be *substantially reduced* on account of the Claimants' contributory fault"[102]. Beyond the contention on substantial reduction, the respondent-state did not submit any particular scheme of apportionment. Similar examples can also be drawn from other awards, like *MTD v. Chile*, where the respondent-state only indicated MTD's business risk but did not elect to submit any quantifications for the apportionment of losses on that basis[103]. The lack of specific submissions by parties on the question of apportionment can be explained by the fact that arbitral tribunals usually sustain the position that the apportionment due to the contributory fault of the injured party is a discretionary exercise. Urdaneta makes an astute observation in this regard "if there is a change in consideration and tribunals encourage parties to plead on this issue, the level of discretion can

[100] *UAB Energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Decision on Annulment (8 April 2020) para 197
[101] Catharine Titi, *The Function of Equity in International Law*, OUP (2021) 124
[102] *Occidental v. Ecuador* (n 46) para 660
[103] *MTD v. Chile* (n 39) para 168

be *de lege ferenda* be reduced"[104]. Among the arbitral awards surveyed, there are no cases so far where the respondent-state has sought any particular proportion in terms of the reduction in damages, placing greater focus on legal questions of significance and materiality of the contributory act, as required under Article 39 of the ARSIWA. In such a situation, it is expected that arbitral tribunals will continue to make equity-based decisions in the process of apportionment.

Returning to the *MTD v. Chile* annulment decision, the annulment committee made several observations regarding situations where losses are usually apportioned equally and the fact that exact reasons for such apportionment are usually not given. Notably, the *MTD* annulment committee in support of its position cited the *Costa Rica Packet* case from 1897 where an arbitral tribunal had held that a state is liable only for the direct consequences of its own unlawful act and it should not have to pay full compensation for injuries partly caused by *external* factors[105].

It is important to note that the *MTD* annulment committee had cited the *Costa Rica Packet* case not directly but from a passage out of scholar Christine D. Gray's monograph *Judicial Remedies in International Law*[106]. After citing the relevant passage on contributory fault from the *Costa Rica Packet* case, Gray had opined that "a reduced amount of damages should accordingly be allowed. The arbitrator gave no exact explanation of the calculations involved in his award."[107] It is likely that the *MTD* annulment committee followed Grey's opinion while making its own observation that "international tribunals which have reached this point have often not given any "exact explanation" of the calculations involved". This is a possible explanation for why the annulment committee was satisfied with the 50% apportionment of loss as decided by the *MTD* tribunal, although the annulment committee itself had initially accepted that the tribunal could have provided more reasons for its decision on apportionment. Reading further into Grey's monograph, a number of cases from the 19th and 20th centuries are cited where various arbitral tribunals agreed to reduce compensation and damages on a certain basis of apportionment, including cases where the external factors were not arising from contributory actions by the injured party[108]. Grey notes the tendency of the tribunals in these instances to not provide any

[104] Urdaneta (n 77) 323
[105] *Costa Rica Packet* (1897) Great Britain/Netherlands, Moore, 4948 as quoted in Christine D. Gray, *Judicial Remedies in International Law* (Oxford University Press 1990) 23
[106] See footnote 129 in the *MTD v. Chile* (n 42) para 101
[107] Gray (n 106) 23
[108] Ibid 24

explanation for the chosen basis of apportionment of damages, which could possibly arise from the difficulties involved in such processes.

The *MTD* award and annulment decision are crucial indicators of the inner considerations of arbitral tribunals when considering apportionment. Given the difficulties of quantifying the impact of contributory actions in most cases, particular where they are not connected to any financial measure, it is not inconceivable why tribunals resort to equitable notions like fairness and reasonableness while deciding splitting of losses. Disputing parties also rarely contest the scheme of apportionment during annulment proceedings, and where they have done so, it is principally on the grounds of failure to state reasons[109].As with other aspects of the processes involved in the assessment of compensation and damages, annulment committees have generally shown deference to arbitral discretion on questions of apportionment.

5. Mitigation of Losses

The duty of a party seeking compensation to mitigate losses arising from an injury is widely recognised as a principle of contract law[110]. The claimant's failure to mitigate such losses becomes the basis upon which the respondent party may seek to limit the amount of damages that may otherwise be awarded by a court or arbitral tribunal. In the parlance of contract law, mitigation is therefore conceived as a duty of an injured party to take reasonable measures to reduce losses, failing which the injured party cannot claim compensation for the losses arising from such a failure to mitigate. While the notion of mitigation is similar to contributory fault in terms of the effects on the damages claimed (i.e. limitation or reduction), the two concepts are analytically distinct. While contributory fault implies that the injured party has committed acts or omissions contributing to the damage caused and its own subsequent losses, mitigation is concerned with the injured party's failure to reduce the damage arising from an external cause or causes[111]. In the context of the law of state responsibility, although the principle of mitigation is not specifically conceived as a duty under international law, it is recognised in terms of its

[109] The respective decisions on annulment in *MTD v. Chile* and *UAB Energija v. Latvia* were two of the cases where the apportionment of losses for contributory fault was specifically challenged under ICSID annulment proceedings for failure to state reasons.
[110] See, for instance Article 7.4.8 of the UNIDROIT Principles of International Commercial Contracts (2004) (UNIDROIT) and Article 77 of the UN Convention on Contracts for the International Sale of Goods 1980 (CISG) which specifically recognises the duty to mitigate damages of the party seeking compensation.
[111] Ripinsky and Williams (n 3) 319

effect on the scope of reparation. The ILC commentary to Article 31 of the ARSIWA states even a completely innocent victim of wrongful conduct is responsible to act reasonably when confronted with an injury. However, the Commentary does not consider mitigation as a legal obligation, even though it is usually expressed as a "duty to mitigate". It is the failure to mitigate that precludes the recoverability to the extent of such failure[112].

In this conception, the failure to mitigate damages is not seen as a failure to perform a specific duty, but rather as a factor to be considered by the adjudicatory body to limit compensation *to the extent* of the failure. The judgement of the ICJ in *Gabcikovo-Nagymaros* case is frequently referred to in the context of mitigation, wherein the Court recognised mitigation as a "general principal of international law"[113]. Notably, the Court held with respect to the principle of mitigation that "while this principle might thus provide a basis for the calculation of damages, it could not, on the other hand, justify an otherwise wrongful act". Taken in the context of investor-state arbitration, it implies that a respondent-state cannot seek to preclude liability on the basis of a failure to mitigate on the part of the claimant-investor. At most, the failure to mitigate can be applied to reduce the amount of compensation or damages determined by the arbitral tribunal. This has been accepted by a large number of tribunals in conceiving mitigation as a 'general principle of law' that is applicable regardless of whether a BIT or other investment agreement incorporates the mitigation principle[114].

In the application of the mitigation principle in investor-state disputes, the respondent-state has to discharge the burden of proof in establishing that the claimant-investor could reasonably have taken certain acts or measures to reduce the losses suffered but failed to do so[115]. The requirement of reasonableness in terms of the actions that could have been taken by the claimant-investor is important here, as the claimant cannot be expected to foresee every type of action that would have had the effect of mitigating its losses. In terms of the requirement on the claimant to have acted reasonably, the arbitral tribunal in *Bilcon v. Canada* observed that the

[112] Article 39 ARISWA Commentary (n 7) para 11
[113] *Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, ICJ Rep. 1997 7, 55
[114] *Papier Vertriebs GmbH* v. *Republic of Poland*, Award (16 October 1995) para 98-102; *Middle East Cement Shipping and Handling Co. S.A.* v. *Egypt*, ICSID Case No. ARB/99/6, Award (12 April 2002) para 482; *EDF International SA, SAUR International SA and Leon Participaciones Argentinas SA* v. *Argentina*, ICSID Case No. ARB/03/23, Award (11 June 2012) para 1302; *Hrvatska Elektroprivreda D.D.* v. *Republic of Slovenia*, ICSID Case No. ARB/05/24, Award (17 December 2015) para 215
[115] *AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan*, ICSID Case No. ARB/01/6, Award, (7 October 2003) para 10.6.4.4.

duty to mitigate arises if a claimant is "unreasonably inactive" after a breach of treaty has occurred or if a claimant engages in unreasonable conduct following such a breach of treaty[116].

The tribunal went on to explain that the twin elements governing reasonableness governed the requirement of the claimant to act as well as to act reasonably. An unreasonable failure to act by the claimant where it could have taken the most fundamental measures to reduce its losses cannot be allowed in terms of compensating the claimant for the same. Additionally, any unreasonable act of the claimant that leads to even more expenses or losses cannot be allowed by the arbitral tribunal to be compensated. Consequently, the reasonability requirement in the context of mitigation ensures that the claimant cannot take undue benefit of its own action or inaction in terms of the additional losses that it incurred out of the impugned unlawful state action for which damages have been claimed. In investor-state disputes, it is this reasonableness of the actions taken by the claimant as a part of its exercise in mitigation that becomes the subject of determination by arbitral tribunals which is largely a factual rather than a legal determination.[117]

Considering the requirement of reasonability of the claimants' actions and the fact that it is generally in any party's interest to limit or reduce its losses, the respondent usually has a difficult task of discharging its burden of proof. The tribunal in *Cairn Energy v. India* made some pertinent remarks on this aspect as follows:

> A mitigation defence is difficult to prove, given that it is in a claimant's own best interest to minimise its loss. As a rule, it will require sufficient evidence to show that a claimant's conduct (action or inaction) following the Respondent's breach was unreasonable, abusive or against its own economic interests. For this reason, tribunals are seldom persuaded by speculative options of mitigation that are proposed in hindsight[118].

Given the relative degree of difficulty of discharging the burden of proof in proving failure to mitigate, successful defences by respondent-states leading to reduction of compensation is relatively rare. However, tribunals in some instances have agreed with respondents regarding the fact that claimants could have taken more effective measures to mitigate their losses Consequently, the tribunals have on a largely discretionary basis agreed to reduce the amount of awarded damages in terms of percentages. The tribunals' decision-making in this respect is

[116] *Bilcon of Delaware et al v. Government of Canada*, PCA Case No. 2009-04, Award on Damages (10 January 2019) para 204
[117] See for instance, see *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13, Award, (7 December 2012) para 319
[118] *Cairn Energy PLC and Cairn UK Holdings Limited (CUHL) v. Government of India*, PCA Case No. 2016-7, Award (21 December 2020) para 1888

similar to how reductions of compensation due to contributory fault have been awarded, as examined earlier. In order to show the similarity of issues involved in the exercise of arbitral discretion in assessing adjustments for mitigation, we will briefly examine a few cases below.

5.1 BRIDAS v. Turkmenistan

In the case of *BRIDAS v. Turkmenistan,* the dispute arose out of the premature termination of a joint venture agreement between the disputing parties, with the claimants' contention that they had been deprived of their bargain as a consequence[119]. The joint venture had been agreed for the purpose of carrying out hydrocarbon operations which were to include the exploration for and the production of oil and gas in an area of Turkmenistan known as the Keimir Block. As a consequence of the refusal by the respondent-state for the continued participation in the project, the claimants demanded damages arising from the repudiation of the contract. On the other hand, the respondent's sought a declaration that the claimant had breached the contract rendering its continued performance impossible or such as to make continued performance of the contract impossible[120]. The arbitral tribunal in the case had, based on an examination of facts and law, found that the respondent's actions were repudiatory and that the claimants were consequently eligible to receive damages for improper repudiation of the agreement. While the tribunal determined the sum of damages based on the estimates of oil production and the remaining period of the contract, it recognised the obligation of the claimants to mitigate losses[121].

On the particular issue of mitigation, which was decided in the third partial award, the arbitral tribunal did not engage in a legal analysis but resorted to the facts regarding the claimants' conduct. The unusual fact in this case was that the arbitral tribunal had itself been involved in attempting to assist the parties in limiting the economic fallout from the case. After the initial set of hearings, the tribunal had suggested that the parties jointly operate the field during the pendency of the dispute and that the revenues be placed in an escrow account[122]. While the respondent-state was amenable to this arrangement, the claimant on its part had refused the arrangement. In the next one and half year period, the claimant also continued to incur costs in

[119] *Bridas S.A.P.I.C., et al, v. Government of Turkmenistan and Turkmenneft*, ICC Case No. 9058/FMS/KGA, First Partial Award (25 June 1999)
[120] Ibid para 83
[121] Ibid para 410
[122] *Bridas S.A.P.I.C., et al, v. Government of Turkmenistan and Turkmenneft*, ICC Case No. 9058/FMS/KGA, Third Partial Award (2 September 2000) para 50

trying to keep alive the joint venture agreement as per which it was maintaining the oil field. Without including these costs, the arbitral tribunal held that the claimant had failed to mitigate its losses, particularly due to its refusal to enter into the offered arrangement between the parties. The tribunal held as follows:

> The extent to which a party is obliged to mitigate and the economic consequences of failing to do so, are matters of judgement based on the evidence and the circumstances applicable to the dispute. The arbitrators deduct from the present value of the lost oil and gas income stream the sum of $50,000,000 as a consequence of the Claimants' failure to mitigate[123].

The decision of the tribunal to deduct a lumpsum amount of 50 million USD (out of a total amount of damages amounting to 495 million USD) was not derived from any particular calculation of value that would have been preserved by taking reasonable measures for mitigation. Although the tribunal held that the extent of the obligation to mitigate would be based on "evidence and circumstances applicable", the tribunal provided only a cursory attention to the same. In effect, the amount seems to be derived from discretion rather than any factual analysis. Arbitrator Hans Smit, in his dissenting opinion to the partial award, recorded his disagreement on this point[124]. Although he agreed on the issue of failure of mitigation by the claimants, Arbitrator Smit noted that the tribunal had effectively decided to award a rounded off figure in damages that did not assess the value lost. He made reference to respondent's expert's figure of 67.9 million USD in lost value which had not accounted for sale of gas. The arbitral tribunals figure of 50 million USD, even though it supposedly included the value of gas sales, actually ended up being 17.9 million lesser than the expert's estimate[125]. Holding that any uncertainty regarding the exact amount of damages that should have been mitigated should be resolved against the claimant, the arbitrator pointed to the tribunal's severe underestimation that was effectively based on its discretion.

5.2 Cargill v. Poland

Similar resort to discretion-based adjustment for failure to mitigate can also be found in *Cargill v. Poland*[126]. The dispute arose out of the claimant-investor Cargill's investment in respondent-state Poland's sugar and sweetener industry. The claimant was involved in the production of

[123] Ibid para 53
[124] Dissenting opnion of Hans Smit (Third Partial Award), *Bridas S.A.P.I.C., et al, v. Government of Turkmenistan and Turkmenneft*
[125] Ibid para 41
[126] *Cargill, Incorporated v. Republic of Poland*, ICSID Case No. ARB(AF)/04/2 Final Award (29 February 2008)

isoglucose, which was not regulated at the time of its introduction in 1994 within the respondent-state's domestic law. However, a law regulating production was passed in 2001, providing for quotas over isoglucose production. The measures, which were taken as a part of respondent Poland's accession process with the European Union, placed significantly low quotas for isoglucose production than what was being produced by the claimant. The cumulative effects on the claimant was a lowering of production and termination of contracts with its customers. Despite negotiations with the government, the claimant was unable to get any relief in terms of revisions in the production quote, which led it to file for arbitration.

On the merits of the case, the arbitral tribunal held that through the imposition of domestic and EU isoglucose quotas, the respondent accorded less favourable treatment to the foreign investor than to domestic producers. Therefore, the respondent was liable for breach of the non-discrimination standards incorporated under the Poland-United States BIT. In addition, the tribunal had also found the respondent to have breached the treaty-based standards of national treatment (imposition of EU and national quotas) and breach of transparency (non-disclosure of the methodology of the quotas applied). Turning to the question of quantum, the arbitral tribunal decided not to award damages arising from the breach of transparency, but on the grounds of discrimination, principally because Cargill refused to quantify or breakdown its investment costs, and chose to rely solely on its DCF analysis, By comparing the actual sales of *isoglucose* between the actual and but-for scenarios (absent the imposition of quotas), the tribunal calculated the amount of losses of 12.4 million USD, from which costs including value arising mitigating activities would be reduced.

On the specific question of mitigation regarding the national quotas, the respondent's submitted that the claimant had overstated its lost profits and that it could have mitigated damages further by producing additional quantities of glucose. Observing that that the mitigation activities during the national quota periods based represented 68% of Cargill's alleged lost isoglucose profits for that period, the tribunal decided that the claimant had taken reasonable measures to mitigate damages[127]. The tribunal therefore agreed to award the claimed sum of 1.9 million USD as damages plus interest. On the second aspect of the claimant's losses arising from the EU quotas that were imposed after Poland's accession on 1 May 2004, the tribunal did not agree in the same manner. The tribunal held that the claimant was aware that the EU quotas would be imposed after the respondent Poland's accession to the EU several years before it occurred and

[127] Ibid para 653

yet decided to continue with its investment in Poland[128]. Therefore, the tribunal held that it was a regulatory or a business risk which the claimant was fully aware of while making the investment and could not consequently seek compensation for the same. Consequently, the tribunal decided to reduce the claimant's net profits by 10% on account of it consideration that the claimant could have mitigated its losses further. It observed in this regard:

> In the Tribunal's opinion, it is highly unlikely that Cargill could have sustained as high a level of mitigation during the EU quota period as during the national quota period […]. Nevertheless, the Tribunal is not convinced that Cargill could not have mitigated its losses to a lower extent, especially through exports. Therefore, it will admit that Cargill's mitigation activities could have amounted to 10% of its lost profits for the period from May 2004 to May 2005[129].

As with the prior case, the arbitral tribunal provided no explanation as to why 10% was the appropriate percentage factor for reducing damages. Neither the claimant nor respondent had, in their submissions, argued for the particular figure in this regard, and it would seem that this was also the product of the arbitral tribunal's discretion. Although the tribunal noted that there was uncertainty regarding the mitigating activities of the claimant with regard to the EU quotas, no further reasoning was provided. Interestingly, the tribunal had also calculated the proportion of claimant's contributory fault at 40% in this case on a seemingly discretionary basis noting that it "appropriately reflects the measure of risk assumed by Cargill".[130] In both cases of contributory fault and mitigation, the tribunal cited difficulty of assessment before turning to a seemingly arbitrary apportionment on both counts.

5.3 EDFI v. Argentina

The third and final case in this assessment is *EDFI v. Argentina*, which arose out of an electricity distribution concession agreement between a local company EDEMSA and the regional government of Mendoza in Argentina, the respondent state[131]. The concession agreement was initially formed pursuant to a reformed regulatory framework regarding the distribution of electricity introduced in the previous year by the regional government of Mendoza. Subsequently, in 1998, the claimant-investors bid 237.8 million USD and won a 51% controlling stake in EDEMSA, which held the electricity distribution concession for a 30-year

[128] Ibid para 668
[129] Ibid para 675
[130] Ibid para 670
[131] *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23 Award (11 June 2012)

period[132]. As a part of the terms, the concession contemplated a tariff rate reflecting the costs incurred by the concessionaire as well as a "reasonable rate of return", periodic tariff reviews so as to take account of inflation and guarantees that tariffs would be calculated in USD and expressed in Argentine pesos for purposes of billing customers[133]. However, a series of measures were introduced prior to and after the institution of national and provincial emergency measures by the Argentine government during a period of economic crises in 2001-02.

Following unsuccessful attempts at renegotiation of the concession agreement and further prejudicial measures at the local government level, the claimant-investors filed for ICSID arbitration against the respondent-state in 2003, while also initiating a divestment from EDEMSA. As a part of the sale of shares in 2005, the claimant-investors were only able to receive only 2 million USD, although they retained the rights to all claims arising from their prior ownership. Following the arbitral process, the arbitral tribunal in the case found that the respondent-state breached its obligations to (i) respect specific commitments undertaken in connection with claimants' investment and (ii) afford claimants Fair and Equitable Treatment with respect to their investment under the Argentina-Belgium-Luxembourg BIT and the Argentina-France BIT.

Without dealing with other issues on merits and quantum, it would be sufficient here to explain the tribunal's findings on the respondent's defences on the grounds of mitigation. The arbitral tribunal received the claimants' contention was that it had decided to mitigate losses by its decision to sell the shares of EDEMSA after a three-and-a-half-year period of fruitless negotiations. On the other hand, the respondent-state had argued that the extended period of renegotiation was reasonable because the period between the measures and the end of the renegotiation was one of complete disruption of all relevant economic indicators. It was the respondent's contention that the claimants elected to sell their shares during a period when renegotiation was still ongoing, thereby incurring immense losses in the process. Only two years later, the 51% shareholding was sold by IADESA, to whom the claimant-investors had sold their shares, for a sum of 60 million USD. Further, both the claimant-investors (as sellers) and IADESA (as buyers) were already shareholders of the EDEMSA prior to the sale of the remaining shares.

The arbitral tribunal, on the basis of a factual analysis, held that it was the claimant-investors responsibility to include a provision in their share-purchase agreement with IADESA to take

[132] Ibid para 71
[133] Ibid para 73

into account a change in the economic framework in Argentina. By failing to do so, they failed in their duty to minimize damages[134]. Proceeding with the decision on the reduction in damages as a consequence of the failure to mitigate, the tribunal held a reasonable seller would try to retain some of the benefits that would have arisen out of the sale of shares. In the absence of any special circumstance, the tribunal found that it would be equitable to apportion an equal share of 50% in the potential benefits to both parties based on the assumption of an arm's length transaction that would be acceptable to both parties. Consequently, the tribunal decided to reduce the amount of damages by 50 percent of the value of the EDEMA shares in 2007. After discounting the value back to time period of Argentina's breach of the BIT provisions in 2001, the amount reduced for failure to mitigate damages was held at approximately 14.1 million USD[135].

As with the cases examined earlier, it is evident that the arbitral tribunal resorted to a discretion-based decision to reduce the value of the shareholding by a percentage factor of 50 percent, which the tribunal considered as 'equitable'. It reasoned that even at that adjusted price, the claimant-investors and buyer IADESA would have enough incentives to enter into the transaction. The tribunal, however, did not resort to any comparable analysis or case study in support of its consideration. Although the tribunal provided *some* reasons for its decision, including the fact that the tribunal was considering the likelihood in an arm's length transaction. It is not clear as to why an equitable split was desirable in the case.

In fact, the tribunal's decision regarding the scheme of quantification for the claimant-investors' failure to mitigate damages was challenged in the subsequent annulment proceedings launched by the respondent-state[136]. The respondent accused the arbitral tribunal of failing to correctly apply the mitigation principle by reducing, without explanation, the difference between the difference in the share prices in 2005 and 2007 and then applying a discount rate to arrive at the 2001 price[137]. However, the tribunal disagreed with the respondent's contention regarding the 50-50 apportionment, observing that:

> …it was based upon the Tribunal's calculation of how, in an arm's length transaction, a buyer and seller might have approached the value of the shareholding knowing that a tariff increase was possible but far from certain. Of course, one can argue over whether 50% is too large (or too small) a reduction but it cannot be said to fall outside the scope of the Tribunal's discretion to

[134] Ibid para 1310
[135] Ibid para 1317
[136] *EDF v. Argentina* Decision on Annulment (n 132)
[137] Ibid para 360

> calculate damages. Nor is the Tribunal's figure one which is unexplained. In addition, the Tribunal naturally discounted the price to arrive at a 2001 figure, something which was both necessary and inevitable as the object of this part of the valuation was to determine what the investment was actually worth at the critical date of 31 December 2001[138]. (emphasis added)

This position of the annulment committee reflects largely the same position as all arbitral tribunals and annulment committees in terms of their position to the exercise of discretion. The committee considered the tribunal's decision on a 50% reduction as being well within the scope of the arbitral tribunal's discretionary powers. Whether it is seen in terms of contributory fault or mitigation, the quantitative apportionments of tribunals are largely respected and followed in the annulment process. In this particular case, which was a rare challenge to a tribunal's decision with respect to mitigation, the committee expressed its satisfaction with the explanations given in the award, which admittedly are more detailed than the reasons observed in previous cases. As long as *some* reasons are given in the award to the committee's satisfaction, the annulment process under the stated grounds in Article 52 of the ICSID Convention are likely to fail. Even if the *MTD v. Chile* decision on annulment is examined on a comparative basis with the present case, the arbitral reasoning regarding the apportionment for contributory fault was even thinner. However, the annulment committee did not consider annulment of the award and instead supplemented it with its own reasoning as to why the arbitral tribunal might have chosen to apportion losses on a 50-50 basis.

5.4 Summary

Unlike with the case of contributory fault, scholarly discussion on mitigation as a defence is limited. It is perhaps explained by the fact that there are relatively few cases involving mitigation as a defence in investor-state disputes, and where they are raised, the high standard for discharge of proof leads to most defences by respondents being set aside by tribunals. A comparison of the cases where allegations of failure to mitigate cases have succeeded suggests that tribunals follow a nearly identical approach to decisions regarding the quantification for mitigation as they do in for contributory fault. Tribunals exercise wide discretion regarding the manner in which reductions are to be given effect due to claimants' failure to mitigate, with factual assessment being the method for determination in a given case. In the absence of evidentiary support, tribunals that have determined failure to mitigate to have occurred may

[138] Ibid para 386

rely on considerations of equity to make an adjustment in the total amount of compensation and damages that have been determined.

The three awards discussed here: *BRIDAS v. Turkmenistan*, *Cargill v. Poland* and *EDFI v. Argentina* point towards a common concept in terms of the tribunal approach to arguments on the grounds of mitigation. None of the respondents in any of the cases argued for a specific reduction to the compensation or damages decided based on the claimant's failure to mitigate. As seen earlier in the case of contributory fault, the parties provide a general argument based on the factual matrix of the case on why the claimant *could* have taken more prudent measures to reduce the losses that they have suffered. The claimant's own defence in this matter is also based on the factual assertions and submit of evidence regarding the measures that it has taken, particularly qualified by the fact that the claimant does not have to go above and beyond measures that are *reasonable* to show that it has satisfied the requirement to mitigate.

6. Conclusion

If the current chapter is considered in tandem with chapter 3, a detailed picture emerges regarding the breadth and scope of arbitral discretion and its role in all of the stages leading to an award on quantum in investor-state proceedings. Beginning with the more structured process of assessments building-up to a sum of compensation or damages, the more unstructured task of reducing, limiting and adjusting this sum occurs at the final stage of determination. Here, instead of legal and valuation principles closely guiding the process of calculation, the role of individual tribunals and their fact-finding process takes precedence. Although customary principles, as incorporated in the ARSIWA, continue to define the broad contours of the causation principle, contributory fault and mitigation, it is primarily the arbitral tribunal's discretion that guides the outcome. By outcome, reference here is made to the decision of whether the compensation value needs to be adjusted for the claimant's own prejudicial acts or omissions. If so, the tribunal must then determine the degree of such adjustments.

Given the large number of arbitral awards that have built a de-facto jurisprudence on the subject of principles limiting compensation, tribunals and annulment committees largely follow the interpretations laid down by prior tribunals in terms of the factual assessments, burden of proof, the margin of estimation as well as equitable considerations. The latter aspects are guided more by the practice of tribunals than any legal principle that seeks to limit the scope of discretion. While certain defined boundaries like considerations of fairness and reasonableness exist with

respect to exercise of discretion, arbitral tribunals largely wield discretion to the limits required for reaching an outcome in a dispute. The gap-filling role of arbitral discretion here gains even more prominence. Even in instances where parties have sought to place limits on discretion, usually by way of annulment proceedings, they have failed to convince annulment committees on the grounds available under the ICSID procedure. The more systemic problems that have arisen as a consequence, and the suggested ways to place some form of control or accountability to discretion are examined in the final chapter.

Chapter 5

Addressing Inconsistency and Incoherence in the Use of Arbitral Discretion

1. Introduction

Having so far examined the nature, scope and characteristics of arbitral discretion and its application in the assessment of compensation and damages, it is necessary to turn to more systemic issues. The exercise of arbitral discretion by tribunals in the context of determination of quantum issues has raised several questions regarding the limits of authority and accountability. Within the broad construction of principles like "wide discretion" or "margin of estimation", tribunals have been able to make decisions as they see fit: whether on the basis of factual and legal assessment or on considerations of equity. Tribunals have also used references to their inherent discretion as a way of avoiding extensive reasoning for making certain decisions that affect the sum of compensation and damages. This practice has been quite evident not only in terms of the valuation (Chapter 3) but also at the stage of reducing the total sum of compensation and damages for reasons external to the respondent's fault (Chapter 4). The effects of the exercise of discretionary powers that is devoid of reasons creates the risk of inconsistent as well as incoherent decisions, having a broader impact on the legitimacy of investor-state arbitration as a dispute settlement mechanism. Although ongoing efforts of states at the multilateral level are aimed at addressing the problems of coherence and consistency, among others, few connections with arbitral discretion have been made so far.

In this context, the present chapter seeks to examine how the problems arising from unfettered arbitral discretion can addressed for the purpose of improving consistency and coherence in the award on compensation and damages. It focuses particularly on the aspect of reasoning in arbitral awards. Comparing both existing legal mechanisms for enforcing the reasoning requirement as well as alternative methods, the chapter completes the overall picture in terms of the role of discretionary decision-making by arbitral tribunals in the assessment of compensation and damages.

The chapter is structured as follows: Section 2 provides a descriptive account of the problem of incoherence and inconsistency that has been an issue of concern for the continued legitimacy of the investor-state arbitration system. It also describes continuing efforts by states to institute

procedural reform and how arbitral discussion figures in the overall discussion. Section 3 then turns to the principal forms of post-award award remedies against improper exercise of discretion on issues of quantum. The various sub-sections in section 3 examines the scope of ICSID annulment, before proceedings on with various grounds for annulment that are available to parties under Article 52(1) of the Convention in Section 4. The conclusions are provided Section 5 of the chapter.

2. Discretion and the Lack of Consistency and Coherence

The manner of exercise of arbitral discretion, as seen in the context of compensation and damages issues in Chapter 3 and 4, poses several questions on how such decisions can be evaluated. In the absence of clear and cogent reasons accompanying the exercise of discretion, it is not possible to discern the basis on which decisions that have a significant impact on the final award are made. To take a specific example, the manner of apportionment of losses due to contributory fault of claimant-investors is largely discretionary in nature. In most of the awards examined, it is not possible to clearly determine why tribunals chose specific percentages for apportionment like 25, 30 or 50 over other alternatives. Similarly, tribunals agreeing to the application of certain valuation methods over others cannot be understood without the context provided by reasons. In fact, the problem of unclear or inadequate reasons accompanying discretion-based decisions is a common thread running through the entire process of assessment, whether compensation or damages. It is compounded further by the fact that when parties seek relief against such decisions through post-award proceedings like ICSID annulment, the annulment committees tend to show a deference towards the arbitral tribunal's discretion. As certain instances like *MTD v. Chile* indicate, some annulment committees have even attempted to rationalise as to why the tribunal in the subject dispute made a certain decision in the absence of explicit reasons in the award.[1]

The consequence of unfettered arbitral discretion is characterised by the dual but closely connected problems of inconsistency and incoherence. As both terms have been widely used in legal scholarship regarding the critical issues with the current arbitration-based model of investor-state dispute settlement, it is important to clarify their meaning in the present discussion. The lack of consistency is widely considered as one of the principal defects in the

[1] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment (21 March 2007) para 93

current system of *ad-hoc* arbitration for resolving investment disputes, where each arbitral tribunal is appointed for the purpose of resolving only a specific dispute[2]. Some of the scholarly criticism of investor-state arbitration draws from the lack of consistency in the interpretation of law by arbitral tribunals[3]. The problem of inconsistent interpretation of law not only affects the rights of parties to a dispute but also predictability regarding the *outcome* of a future dispute[4]. It is not expected that the dispute settlement system will be fully and mechanically consistent, given the unique factual and legal contexts of each case. However, it is a reasonable expectation that any legal system would be consistent in terms of the scope and meaning of the legal standards at a broader level. Without such consistency, any legal system would largely have a largely arbitrary adjudicatory mechanism where the outcome would differ on the basis of the adjudicator in question[5]. At a systemic level, the absence of a legal mechanism to correct inconsistencies in interpretation might lead to a loss of faith in the dispute settlement system, challenging its very legitimacy. This is particularly the concern with investor-state arbitration as a dispute settlement system that is said to be going through a period of 'legitimacy crisis'[6].

The idea of incoherence is tied closely with the inconsistency problem and consequently, both terms are often in conjunction with each other. The accumulation of inconsistent interpretations of law over time leads to the lack of coherence regarding the meaning of legal standards and their scope of applicability. Calamita explains the manner of creation of incoherence in the investment treaty regime as characterised by the periodic awards that are inconsistent with interpretation and application of similar or identical provisions of other investment treaties. This might also be caused by awards that are inconsistent in terms of interpretation and application of investment agreements which have been the subject of prior interpretation and

[2] Julian Arato, Chester Brown and Federico Ortino, 'Parsing and Managing Inconsistency in Investor-State Dispute Settlement' (2020) Journal of World Investment and Trade 21
[3] Ibid 341
[4] Julian Arato et al., 'Working Group No 3: Lack of Consistency and Coherence in the Interpretation of Legal Issues' (2019) Academic Forum Concept Paper on Issues of ISDS Reform <https://www.cids.ch/images/Documents/Academic-Forum/3_Inconsistency_-_WG3.pdf>
[5] Lon Fuller, *The Morality of Law*, (Yale University Press 1969) 65–70
[6] Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73 Fordham Law Review 1521; Thomas Dietz, Marius Dotzauer and Edward S. Cohen, 'The Legitimacy Crisis of Investor-State Arbitration and the New EU Investment Court System' (2019) 26 Review of International Political Economy 4, 749; Ulyana Bardyn, 'The Legitimacy Crisis or Tempest in a Teapot?' (2019) 12 Investment Treaty Arbitration and International Law 8; Charles N. Brower and Stephan W. Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?' (2009) 9 Chicago Journal of International Law 2; Sergio Puig and Gregory Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law' (2018) 112 American Journal of International Law 361

application. Resultantly a horizontal jurisprudence may arise in which it can prove to be difficult for investors and states to form an ex-ante understanding of the position of law[7].

The effects of an incoherent system of investment law leads to the same issue as inconsistency, i.e. the withering of the legitimacy of the legal system and the search for alternatives among stakeholders. In an incoherent system, states and investors would have no certainty regarding their rights and obligations, consequently paring down their participation in the system. Resolution of disputes would also become difficult considering that terms not specifically defined in the treaties would have different interpretations based on the tribunal in question. This would particularly affect aspects like compensation and damages where arbitral tribunals draw significantly from prior practice of tribunals as stated in the awards[8]. Most of the current discussions on the subject of consistency and coherence focus on issues of treaty interpretation and the content of the standards of investment protection[9].

In the specific case of inconsistency and incoherence issues related to exercise of arbitral discretion, current discourse on reform is primarily concerned with the aspect of "interpretive discretion" of arbitral tribunals with respect to the content of investment treaties. For instance, the United Nations Centre for Trade and Development (UNCTAD) has coordinated efforts over the past decade towards prescribing reforms of international investment agreements of member countries. Among its suggested framework for reform, UNCTAD has considered how some of the coherence and consistency issues in investor-state dispute settlement may be resolved by narrowing the interpretive discretion of arbitral tribunals. For this purpose, UNCTAD suggests that treaty-based reform measures such as issuance of joint interpretative statements by treaty parties and reference to global standards on issues of sustainability, human rights and environmental protection as possible options[10]. For alleviating problems of inconsistency and incoherence, UNCTAD lays emphasis on the need for improving systemic consistency "between IIAs, between IIAs and other international law instruments affecting investment, but also between IIAs and domestic policies"[11]. Besides treaty-based reforms, UNCTAD's policy

[7] N. Jansen Calamita, 'The (In)Compatibility of Appellate Mechanisms with Existing Instruments of the Investment Treaty Regime' (2017) 18 Journal of World Investment & Trade 586
[8] Giovanni Zarra, 'The Issue of Incoherence in Investment Arbitration: Is There Need for a Systemic Reform?' (2018) 17 Chinese Journal of International Law 163
[9] James X. Zhan et al., UNCTAD'S Reform Package for the International Investment Regime, UNCTAD Report (2018)
[10] Ibid at 76
[11] Ibid at 23

prescriptions also extend into measures like reforming the arbitration-based model of ISDS or finding alternatives means of dispute settlement.

A parallel effort towards addressing many of the pressing issues in investor-state dispute settlement, including problems of inconsistency and incoherence, was instituted by the United Nations Commission on International Law (UNCITRAL) by assigning one of its working groups, Working Group III (WGIII), with a broad mandate to work on possible reform of ISDS, although the mandate was limited to considering only procedural aspects rather than on substantive rules[12]. Starting with its 34th session in November-December 2017, WGIII began its work by identifying the key concerns and problem areas with ISDS that was based on research reports, comments by member-states involved in the working group as well as notes provided by the UNCITRAL Secretariat[13]. Among a range of procedural issues that were identified by the WGIII on the basis of the findings of a Secretarial note, the issue of inconsistency and incoherence of arbitral decisions was particularly noted as a pressing concern. The UNCITRAL Secretariat defined the scope of desirability of a coherent dispute settlement system that would ensure that identical or similar situations are treated in the same way. A consistent ISDS system would support the rule of law and also provide stability to the environment for foreign investment. On the other hand, lack of inconsistency and coherence would be detrimental to the reliability, effectiveness and predictability of the overall regime, as well as the credibility of ISDS[14].

These observations by the Secretariat are largely consistent with scholarly opinion on the need for a coherent system of arbitral decision-making. The risk to the credibility of the existing system is essentially the threat against its legitimacy, given that no participant would wish to engage in a dispute settlement system that is inherently unreliable and unpredictable. The Secretariat additionally identified three sources that might contribute to the problem of lack of consistency and coherence in the ISDS regime: (1) broad and vaguely drafted treaty standards that left arbitrators with a wide latitude of interpretation (2) variations in scope of applicability of ISDS clauses across treaties, and (3) variations in the conditions for access to arbitration across treaties.[15]

[12] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Fourth Session', (2017) U.N. Doc A/CN.9/930/Rev.1 2-3
[13] Ibid 3
[14] UNCITRAL, 'Possible Reform of Investor-State Dispute Settlement (ISDS): Note by the Secretariat' (2017) U.N. Doc A/CN.9/WG.III/WP.142 7
[15] Ibid 7

The idea of the "wide latitude of interpretation" as noted by the UNCITRAL Secretariat corresponds to the concept of interpretative discretion that was identified by UNCTAD as a contributory factor to inconsistency and incoherence issues in ISDS. It is important to note that the UNCITRAL Secretariat's findings were based largely out of a research paper authored by Prof. Gabrielle Kaufmann-Kohler and Michele Potestà that had been commissioned by UNCITRAL[16]. In their report, the authors had identified that the treaty standards that were formulated in vague and overly broad terms in investment treaties resulted in the grant of "excessive discretion to arbitrators" who had to interpret and apply those standards[17]. Given that there are no appropriate legal mechanisms to remedy or limit the inconsistent interpretations that arise as a consequence, the authors noted that it remained as a major point of concern for the future credibility and legitimacy of the arbitration-based ISDS system. The WGIII accepted and raised the problem of lack of consistency and incoherence as a distinct issue that would be part of its ongoing work. However, as discussions progressed subsequently over 2018 and 2019, the Working Group made particular observations of regarding the necessity of taking a nuanced approach to the subject, considering that not all forms of inconsistencies are inherently undesirable. In its 35th session, the Working Group observed that the existence of divergent outcomes was not in itself a concern as treaty provisions could be interpreted correctly but applied differently based on the facts and evidence of a case. Applying general principles of treaty interpretation applied on the same treaty could also lead to varying interpretations. However, inconsistency could become the subject of concern when the same standard or rule of customary international law would be interpreted different without justifiable grounds for the distinct interpretations[18].

The notion of "unjustifiable inconsistencies" thus became the issue of concern to be addressed in the form of possible reform measures by the WGIII. This development ensured that not all diverging interpretations would be considered as contributory factors to inconsistencies, and that a certain level of inconsistency and coherence would in any case be unavoidable in the ISDS system, considering the textual diversity among investment treaties and other agreements. The interpretive discretion of arbitral tribunals would, to a reasonable extent, be unavoidable

[16] Gabrielle Kaufmann-Kohler and Michele Potestà, 'Can the Mauritius Convention Serve as a Model for the Reform of Investor-State Arbitration in Connection with the Introduction of a Permanent Investment Tribunal or an Appeal Mechanism? - Analysis and Roadmap' (2016) Geneva Centre for International Dispute Settlement (CIDS)
[17] Ibid 11
[18] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Fifth Session' (2018) U.N. Doc A/CN.9/935 5

regardless of the method of dispute settlement being used. In more recent developments, the WGIII having accepted the desirability of reform of the ISDS system is now considering the various options of reform available, particularly in terms of proposals of member-states for review and appellate systems along with the option of establishing a multilateral investment court (MIC), which has been championed particularly by the European Commission[19]. The issue of inconsistency and incoherence in arbitral decision-making is thus tied closely to the idea that broad and vague treaty standards grant wide interpretive discretion to arbitral tribunals in interpreting these standards. While some degree of inconsistencies are natural, particular instances where inconsistencies in legal interpretation are unjustifiable and may lead to systemic problems in the dispute settlement system.

In considering these propositions from the lens of the particular species of arbitral discretion that we have examined in the context of compensation and damages, some interesting observations can be made. First, it is essential to differentiate the notion of interpretive discretion relating to the interpretation of legal standards from the kind of arbitral discretion exercised by tribunals in assessing compensation and damages. Arbitral discretion plays a role at several stages of the arbitral process, generally differentiated in terms of procedural and substantive issues. Substantive arbitral discretion is exercised in a wide range of issues including treaty interpretation, determination of the standard of proof, determination of compensation and damages, costs etc. However, the issue of inconsistency and incoherence in ISDS has been discussed only in the context of substantive discretion regarding treaty interpretation, as evident from the scholarly contribution and the ongoing ISDS reform efforts by international organisations, as highlighted above. While some member-states were keen on including issues of calculation of compensation and damages in the UNCITRAL WGIII proceedings, the working group's mandate being limited to procedural issues meant that it could not be taken up among the issues of for reform considerations but could be linked to more broader concerns like incorrect decisions by arbitral tribunals[20].

Second, the general scholarly position regarding the role of interpretive arbitral discretion in compounding the problems of inconsistency and incoherence needs to be differentiated from the notion of arbitral discretion in the context of compensation and damages. The broader effects are largely the same i.e. the exercise of wide discretion by tribunals leading to

[19] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Resumed Thirty-eighth Session' (2020) U.N. Doc A/CN.9/1004/Add.1

[20] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Seventh Session, (2019) U.N. Doc A/CN.9/970

inconsistencies in the application of principles governing compensation and damages. However, the scope of discretion of arbitral tribunals is significantly narrower on issues of merit than for quantum. The standards of treatment in investment in investment treaties, even where vague and broadly drafted, are still far more structured than treaty provisions governing compensation and damages. In fact, tribunals rely largely on customary international law principles as encoded in the ARSIWA to draw inferences regarding the applicable legal standard for assessment of compensation and damages. Beyond standards, as tribunals have to decide on the varied issues involved in quantification, such as valuation methods, lost profits, interest rates, etc. the scope of discretion becomes broader. Even on issues such as applying limitations or adjustments to damages, tribunals are only guided by customary and general principles of law, such as contributory fault and mitigation. This is in sharp contrast to the scope of discretion that is available to tribunals when interpreting the contents of a treaty standard, where the text of the treaty is supplemented by customary international law as well as relatively well-defined rules on treaty interpretation[21].

In the specific context of compensation and damages, the exercise of unfettered arbitral discretion therefore poses a unique set of challenges in terms of its contribution to inconsistency and incoherence in decision-making and more broadly to the system of investor-state arbitration. The principal issue in this regard is not the diverging interpretation of the same or largely similar treaty standard, but rather the basis, legal or factual, on which such decisions are made. For example, the particular issue of apportionment of contributory fault can be considered here. The dissenting opinion of arbitrator Brigitte Stern in *Occidental v. Ecuador* is instructive of the general lack of explanation of the basis for the apportionment, leading to a speculative exercise of reading the mind of the tribunal[22]. Stern ascribed the majority tribunal's decision to reduce the total compensation by 25 percent instead of 50 percent to differences between her and the majority tribunal in terms of the appreciation of facts. Stern felt that the majority tribunal did not consider the claimant-investor's unlawful act to be as severe as it ought to have considering its effect on the respondent-state's subsequent actions. However, it is difficult to tell whether this was indeed the case, as the reasoning in the award leading up to the decision on apportionment contains no explanations. Another instance can be drawn from the stage of the valuation process, such as the basis of a tribunal's choice in deciding whether

[21] See Vienna Convention on the Law of Treaties 1969, Done at Vienna on 23 May 1969. Entered into force on 27 January 1980. United Nations, Treaty Series, vol. 1155 at 331

[22] Brigitte Stern, Dissenting Opinion, *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11 (20 September 2012)

to apply Discounted Cash Flow (DCF) analysis in order to calculate the investment value. On this aspect, the decision to apply or reject the application of DCF and the grounds for the same often becomes the subject of the arbitral tribunal's discretion. While certain arbitral tribunals might, as a principle, avoid the DCF method where the investment in question is in its early stages or without a historical record of cash flows, others have shown greater inclination towards applying DCF regardless. The pro-DCF approaches taken by the tribunals in *Gold Reserve v. Venezuela*[23] and more recently in *Tethyan Copper Company v. Pakistan*[24] can be contrasted with the more conservative approach of tribunals until the early 2000s.

Some recent awards have also emerged where parallel tribunals have taken contrary positions regarding the suitability of DCF in cases involving largely the same subject matter of dispute. In the award on quantum in *DT v. India*, the subject matter of the dispute involved the unlawful annulment of a contract for the lease of electromagnetic spectrum between the respondent state and the claimant-investor's indirect subsidiary[25]. After having found the respondent liable for breach of treaty standards of fair and equitable treatment in an interim award, the tribunal was faced with the claimant's request that the fair market value of the investment should be made on the basis of DCF analysis[26]. The arbitral tribunal found itself in agreement with a series of arbitral awards where it was held that that DCF is generally inappropriate where the subject company is not a going concern and lacks an established record of profitability. Based on this principle, the tribunal assessed the financial record of the claimant's subsidiary to find that it could not be considered as a going concern, and therefore, the DCF method should not be used to assess its value.

In contrast to the above case, the tribunal in *cc/Devas v. India* took a opposite position on the aspect of DCF-based valuation[27]. Here, the subject matter of arbitration concerned the same action by the respondent-state in its termination of the agreement for lease of electromagnetic spectrum that it had signed with the claimant as in the case of *DT v. India*. However, in this case, the majority tribunal accepted the claimant's contention in favour of DCF analysis as appropriate[28]. Relying primarily on the *Tethyan Copper Company v. Pakistan* award, the

[23] *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award (22 September 2014)
[24] *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, ICSID Case No. ARB/12/1 Award (12 July 2019)
[25] *Deutsche Telekom AG v. Republic of India*, PCA Case No. 214-10, Final Award (27 May 2020)
[26] Ibid para 12
[27] *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. Republic of India*, PCA Case No. 2013-09, Award on Quantum (13 October 2020)
[28] Ibid para 537

cc/*Devas* tribunal held that even in the absence of a track record of performance, the DCF method could still be applied. The tribunal accepted that the reasoning applied in the *Tethyan* award was based on the commodity nature of the asset that was the subject of investment. However, it held that the present case involved a service with "with some commodity features"[29]. Adding further that just as in the mining sector, where DCF is a common method of valuation, a similar method existed in the telecom service sector and that it had been correctly applied in the instant case.

Even with the largely similar set of facts and subject matter of the dispute, the contrasting approach of tribunals is indicative of the inconsistencies that can arise on issues of compensation and damages. Both cases are also instructive of the diverging approaches taken by tribunals over time, with one strand placing stringent pre-conditions to the application of DCF method, while the other strand considering it immaterial to the determination of suitability of DCF. In the absence of an external corrective mechanism, such divergences are likely to subsist in investor-state arbitration. But more important perhaps is the inconsistency in the basis for making decisions, as noted in the *DT* and *cc/Devas* awards with respect to the valuation method. In the latter case, the dissenting arbitrator Justice Anil Dev Singh sharply expressed his disagreement with the majority tribunal regarding the application of DCF method[30]. Arbitrator Singh not only contrasted the divergent position taken by the majority tribunal with the *DT v. India* tribunal but also the prior award of an ICC tribunal in the same matter, where DCF had been rejected as unsuitable in the case[31]. The arbitrator also expressed his disagreement with the majority tribunal in terms of its reliance on the *Tethyan* award.

The examples cited above, and the cases studied in the previous chapters provide ample evidence of the various kinds of inconsistencies that arise in the making of awards on compensation and quantum. Even though not all such inconsistencies can be considered to arise due to the wide margin of discretion alone, it must be accepted that discretion enables tribunals to take diverging positions from established arbitral practice. While in the instance of *cc/Devas* the tribunal did provide reasons on the basis of which it made its decision (whether right or wrong), the practice of tribunals has generally been marked with a substantial lack of clear and cogent reasons for decisions in various stages of the quantification and post-quantification adjustment process. Besides the issue of systemic coherence, the absence of clearly described

[29] Ibid para 537
[30] Justice Anil Dev Singh, Dissenting Opinion, *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. Republic of India*, PCA Case No. 2013-09
[31] *Devas Multimedia Private Limited v. Antrix Corporation Limited*, ICC Case No. 18051/CYK

reasons for an award of quantum contributes to incoherence *within* the award in itself, thereby making it difficult to determine why and how a tribunal got to a decision that it did. The accumulation of such awards over time will likely create the same problems as inconsistency and incoherence in the interpretation of treaty standards will do – lack of predictability and certainty as to the outcome of the award that has a detrimental effect to the legitimacy of the dispute settlement system.

It may be argued that the problem of inconsistency and incoherence in the specific context of compensation and damages poses greater risks to the legitimacy of the arbitration-based system than those arising from interpretative inconsistencies. After all, the most important consideration for the disputing parties in a given case is not liability but quantum. For a claimant-investor, a successful claim for quantum can have a host of effects depending on its financial position. Where the investor's business has been disrupted completely due to the host state's actions, such an award can completely revive its business. On the other hand, a significant award on damages against a host state with a fragile economy may severely affect its financial health that can have disruptive second-order effects across its economy[32]. A case in point here is the damages award in *Tethyan Copper Company v. Pakistan*, where the sum of damages of approximately 6 billion USD awarded by an ICSID tribunal in 2019 was equivalent to a loan package that had been sanctioned by the International Monetary Fund during the same period[33]. While Pakistan has challenged the tribunal's basis for selection of the modified DCF criteria under ongoing annulment proceedings, the threat of the large sums at risk due to regulatory action is itself a cause for concern.

Therefore, control mechanisms against possible arbitrariness under the guise of discretion are necessary for avoidance of systemic inconsistency and incoherence. While a margin of discretion is necessary and even desirable when tribunals have to make difficult decisions, it should not be allowed to become so broad as to subsume any requirement of reasonability. As one commentator rightly puts it, discretion must not have a place "beyond the shadow of the law"[34]. Mechanisms for exerting control against such defective or improper exercise of

[32] Martins Paparinskis, 'A Case Against Crippling Compensation in International Law of State Responsibility' (2020) The Modern Law Review 1

[33] Christopher Finnigan, 'Long Read: The Reko Diq 'Fiasco' in Perspective: Pakistan's Experience of International Investment Arbitration', *LSE Blogs* (14 August 2019) <https://blogs.lse.ac.uk/southasia/2019/08/14/long-read-the-reko-diq-fiasco-in-perspective-pakistansexperience-of-international-investment-arbitration/>

[34] Silke Noa Elrifai, 'Equity-Based Discretion and the Anatomy of Damages Assessment in Investment Treaty Law' (2017) 34 Journal of International Arbitration 5, 871

discretion are found in the form of post-award remedies. The following section addresses the grounds on which remedies may be available to disputants.

3. Post-Award Remedies

The nature of *ex-post* or post-award remedies available to the disputing parties depends on the nature of the arbitral proceedings that have led to the formation of the arbitral award. As noted earlier in Chapter 2, investor-state arbitration proceedings can broadly be classified as ICSID and non-ICSID proceedings, with such non-ICSID disputes mostly comprising arbitrations held under UNCITRAL Arbitration Rules or other institutional rules. Where parties are dissatisfied with arbitral reasoning, including discretion-based decisions, their options are limited to seeking remedies against the award. Therefore, *ex-post* remedies against defective exercise of arbitral discretion is encapsulated by post-award remedies that are made available to disputants. The three principal categories of challenges that are observed against awards on damages are[35]:

1. Against defects in the scope of the damages award
2. Against errors in the calculation of damages
3. Against defects in the process of arriving at the award

The first category of challenges comprises of actions that pertain to the identification of the investor, investment or claim, and any tribunal decision that misidentify the appropriate parties or the scope of the claims of parties. For example, an award on damages awarded to the wrong party in the dispute, or an award that permissible limits of damages already defined by the subject BIT or investment contract would be subject to challenges within this category. The second category comprises of challenges that are arithmetic or mechanical in nature, including the use of approximations, misapplication of the valuation method decided by the tribunal etc.

It is the third category that is most relevant in the present discussion, and which includes the process by which the arbitral tribunal has fixed an award on quantum. In ICSID arbitration, the principal remedy against such a defect lies under annulment proceedings, as provided under grounds for annulment in Article 52(1) of the ICSID Convention. In non-ICSID arbitrations,

[35] Christina L. Beharry, 'Post-Award Challenges of Damages Assessments' in Christina L. Beharry (ed.), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018) 430

the principal remedy available to parties is to challenge the award via national courts, principally through set-aside proceedings at the seat of arbitration[36]. Annulment is a feature unique to ICSID arbitration and there are no exactly equivalent remedies available under other arbitration rules, with setting-aside proceedings bearing closest resemblance. Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, or the New York Convention, certain grounds are provided under Article V as per which recognition and enforcement of the arbitral award may be refused by a competent authority at the request of a party[37]. The domestic law in several states that are signatories to the New York Convention are also modelled along Article V governing grounds for such refusal of recognition and enforcement. However, none of the grounds under Article V hit upon the decision-making process of the arbitral tribunal, though defects in arbitral procedure are contemplated. In this regard, Article V cannot be considered as analogous to Article 52 of the ICSID Convention[38].

While setting-aside and proceedings against recognition or enforcement of awards may *incidentally* nullify a particular award having defects in the process of arriving at a decision, it is principally the ICSID annulment process where a freshly constituted ad-hoc committee has the authority to look at the reasoning applied in an arbitral award. Therefore, the question of possible *ex-post* remedies against defective exercises of arbitral discretion can be considered properly only against the decisions of various annulment committees. None of the post-award remedies available either under ICSID or non-ICSID arbitrations constitute a mechanism for control against defects in the exercise of arbitral discretions that are not related to some form of mistake: arithmetic errors, omissions or misapplication of standards[39].

3.1 Scope of ICSID Annulment Proceedings

It is by means of seeking annulment of an arbitral award that provides the best opportunity for parties to challenge discretion-based decision-making which they consider to be defective. Although the defects in the exercise of discretion can be conceived in several ways, under the language of Article 52(1) of the ICSID Convention, disputing parties generally take the

[36] Christoph Schreuer et al., *The ICSID Convention: A Commentary* (Cambridge University Press 2nd ed. 2009) 900

[37] See Herbert Kronke et al. (eds.), *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention* (Wolters Kluwer 2010)

[38] Mark B. Feldman, 'The Annulment Proceedings and the Finality of ICSID Arbitral Awards' (1987) 2 ICSID Review 1, 85

[39] Where the discretionary decisions contain mathematical errors or omissions, they can be corrected under other means such as rectification. See, Beharry (n 35)

grounds of Article 52(1)(b) ("the Tribunal has manifestly exceeded its power") or more commonly under Article 52(1)(e) ("that the award has failed to state reasons on which it is based"). These grounds are among the five available under Article 52(1), which is fully stated as follows:

> Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:
>
> (a) that the Tribunal was not properly constituted;
>
> (b) that the Tribunal has manifestly exceeded its powers;
>
> (c) that there was corruption on the part of a member of the Tribunal;
>
> (d) that there has been a serious departure from a fundamental rule of procedure; or
>
> (e) that the award has failed to state the reasons on which it is based

Before considering the specific issue of arbitral discretion as evaluated by various annulment committees, it is crucial to understand the scope of the annulment process. Commentators as well as annulment committees like to particularly point out at the outset that annulment is not an appellate process[40]. Schreuer provides two reasons differentiating annulment from an appeals process: first, due to the result of the process, and second, relating to the aspects of the decision under review[41]. The only result that can arise from a successful application for annulment is a full or partial annulment of the arbitral award, while an appellate process provides the adjudicator with the option to modify a decision or make a substitution to the award based on their own findings. An ICSID annulment committee does not have the authority under Article 52 to modify an award and thereby institute a modification in the outcome of the subject award. By agreeing to annul the award, the annulment committee therefore invalidates a part of or the complete award.

Secondly, the annulment process is concerned only with the question of whether the process by which the arbitral tribunal reached its decision was legitimate. Annulment committees are not concerned with the correctness of the award, nor is it their duty to examine the correctness of the award. The committee in *CDC Group v. Seychelles* observed that annulment under Article 52(1) of the ICSID Convention is concerned with determining whether the underlying

[40] David D. Caron, 'Reputation and Reality in the ICSID Annulment Process: Understanding the Distinction Between Annulment and Appeal' (1992) 7 ICSID Review 21
[41] Schreuer et al. (n 36) 901

procedure was fundamentally fair. The assessment here must not stretch into the merits of the case, but is concerned with the integrity of the tribunal, observance of procedural guarantees, the consent of parties and coherence in the tribunal's reasoning[42].

The Tribunal decided to interpret Article 52(1) based on its 'ordinary meaning' in accordance with the practice prescribed by the law of treaties[43]. Its reference to the fundamental integrity as the principal concern defines the scope of annulment as procedural in nature, with its focus on process rather than outcome. On the specific aspect of reasoning, the tribunal was keen to point out that the visibility of the reasons and their coherence should be the only considerations during the annulment process. In considering the restricted scope of annulment, the annulment committee in *MINE v. Guinea* observed that annulment is a limited remedy by the exclusion of review of merits. Annulment is not meant to correct incorrect decisions and the grounds under Article 52(1) must not be used to reverse an award on issues of merits but under the guise of procedural problems[44].

This interpretation conceived annulment as a 'limited remedy', with its concerns limited to issues of procedure rather than merit. Although some annulment committee decisions and their reasoning have blurred the boundaries between appeal and annulment, as we will see later, there is a general consensus regarding the overall scope of the annulment process. A related aspect of this limited remedy is that annulment is conceived as a limited exception to the finality of an arbitral award[45]. The principle of finality of an arbitration process is designed with the goal of achieving an efficient process in terms of costs and speed, both of which are important considerations for the disputing parties[46]. At the same time, considerations of correctness of the award are equally pressing, given the high financial stakes involved in disputes of such nature and the need for a clear determination of the rights of the parties involved. Therefore, the function of annulment is to provide a balance between finality of outcome and correctness of the award. As Feldman observes, there has always been some tension in arbitration law between the need for fair procedure and just decisions and the specific advantages of arbitration for disputing parties. Such perceived advantages include informality, expedition and economy. There is also an expectation of the exercise of equity in the general arbitral process that would

[42] *CDC Group plc v. Republic of Seychelles*, ICSID Case No. ARB/02/14, Decision on Annulment (25 June 2005) para 34
[43] Ibid para 33
[44] *Maritime International Nominees Establishment v. Republic of Guinea*, ICSID Case No. ARB/84/4, Decision on Annulment (22 December 1989) para 4.04
[45] Beharry (n 35) 445
[46] Schreuer et al. (n 36) 903

not be there in the case of courts. Moreover, arbitration-specific values are protected by important principles of arbitration law such as party autonomy and the finality of arbitral awards[47]. It is this tension among principles that defines the scope of annulment process under the ICSID Convention. Consequently, the interpretation of the grounds for annulment as given under Article 52(1) also reflects a compromise of contending principles, where annulment committees have agreed that these grounds should neither be read too broadly, nor should remedies be refused on an unduly narrow interpretation.

Thus, applying these understandings of the scope of annulment, a clearer assessment of the perspective of the annulment committees towards challenges raised under against discretionary decision-making can be made. Before moving to the specific grounds for annulment sought by parties involving the exercise of discretion on quantum, the observations of the *EDFI v. Argentina* annulment committee with respect to the committee's own discretion to annul decisions make for interesting observations. The tribunal dealt with the question of whether a committee is bound to annul awards when it finds that one of the grounds for annulment has been made out, or whether it exercised a margin of discretion to decide whether or not do so. Referring to the final sentence in Article 52(3) of the ICSID Convention, which states that "the Committee shall have the authority to annul the award or any part thereof on any of the grounds set forth in paragraph (1)", the annulment committee observed that the phrase "shall have the authority to annul" provided a margin of discretion to annulment committees. It went on to find as follows:

> The Committee concludes that, even if an Article 52(1) ground is made out, it nevertheless retains a discretion as to whether or not to annul the award. That discretion is by no means unlimited and must take account of all relevant circumstances, including the gravity of the circumstances which constitute the ground for annulment and whether or not they had – or could have had – a material effect upon the outcome of the case, as well as the importance of the finality of the award and the overall question of fairness to both Parties[48].

The argument that the annulment committee retains a certain degree of discretion in deciding whether or not to annul an award allows greater leeway on the part of the committee to defer to the arbitral tribunal's decision-making, should it decide to do so. Unless the tribunal has committed a particularly severe infraction which would draw any of the grounds under Article

[47] Feldman (n 38) 87

[48] *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23, Decision on Annulment, (5 February 2016) at para 73

52(1), the annulment committee can decide to refuse annulment of the award consequently. The *EDFI* annulment committee here provides three considerations for an annulment committee: the material effect on outcome, considerations of finality as well as fairness to the disputing parties. Naturally, it would be up to the annulment committee to decide how materially the tribunal's impugned actions would affects the overall outcome, allowing for a more lenient approach towards instances where such actions are not particularly egregious. Some earlier annulment committees have termed this as a general precaution against annulling awards out of a "trivial cause"[49]. This creates an additional burden on the party seeking annulment, as mere cursory evidence of a tribunal's actions qualifying under Article 52(1) may not be enough to secure annulment. Given the already difficult task of discharging the burden of proof arising from discretionary actions of the arbitral tribunal, an additional layer of discretion on the part of the annulment committee makes the task of annulling an award more complex.

Statistics regarding ICSID's caseload also attest to this: in the period from 2011-2020, 225 ICSID awards were rendered which was the highest number of awards in a decadal period beginning from 1970[50]. Among the total annulment proceedings, 56 decisions rejected the application for annulment, while 25 proceedings were discontinued and only 7 proceedings led to a full or partial annulment of the award. This means that out of a total of 88 annulment proceedings (56+7+25) that were initiated in this 10-year period, only about 8 percent of cases ended with some form of annulment. In the decade prior, 2001-2010, the rate of successful annulments were much higher (30%), even though the proportion of annulment proceedings raised to the number of ICSID arbitral awards rendered was roughly similar. It is evident that successful annulment actions have become harder to come by, and successful annulment of an award (whether in full or partial) is generally difficult to achieve for disputants. The reasons for this may be varied, including improved procedural integrity of ICSID arbitrations, greater deference by annulment committees to the decisions of arbitral tribunals, rising costs of annulment, among others.

[49] *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, (3 July 2002) at para. 63

[50] ICSID, 'Annulment Proceedings under the ICSID Convention: Outcomes', ICSID Caseload Statistics 2021-2 (2021)

4. Grounds for Annulment

Having examined the scope of ICSID annulment proceedings and the resulting constraints that are placed on annulment committees in terms of the remedies, it is necessary to examine the particular grounds for annulment. Out of the five grounds available under Article 52(1), challenges regarding awards on quantum are raised on the grounds of (1) manifest excess of powers (2) serious departure from the fundamental rules of procedure, or (3) failure to state reasons[51]. Parties may also tend to seek annulment based on a combined reading of two or all three grounds, instead of drawing solely from a single ground[52]. Considering the focus in this research work on arbitral discretion within the larger rubric of arbitral decision-making, the following sections will focus on how annulment committees have addressed discretionary elements.

4.1 Manifest Excess of Powers

Under Article 52(1)(b) of the ICSID Convention, the ground for manifest excess of powers is made out against actions and decisions that exceed the powers granted to the tribunal in the arbitral process. As made evident by the phrasing, the two essential elements for a valid case for annulment on this ground are: (1) the tribunal must have exceeded its powers, and (2) such excess must have been manifest i.e., it must be self-evident or obvious from a reading of the award[53]. The term "manifest" can also be interpreted as requiring such instances of excess of powers to be particularly severe, with an effect on the outcome.

While an arbitral tribunal can be manifestly in excess of its powers in terms of jurisdiction, the decision-making element that is usually drawn under this ground is with respect to its application of the law. Parties generally seek to challenge the arbitral awards decision under this ground based on the argument that the arbitral tribunal has failed to apply the law correctly or acted *ex aequo et bono* without authorisation of the disputing parties[54]. There is an important distinction to be drawn in this context, however, between actions of the tribunal amounting to

[51] Beharry (n 35) 446
[52] See for instance the decision on annulment in EDFI v. Argentina, where the respondents sought annulment against the decision on damages based on the three grounds. *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23, Decision on Annulment, (5 February 2016) at para 352
[53] Schreuer et al. (n 36) 938
[54] See *MINE v. Guinea* (n 44) para 5.03

failure in the application of the law as opposed to erroneous application of the law. While the former is a valid ground for annulment, the latter does not amount to a decision that may be annulled. The failure of the tribunal to apply the applicable law in this context should be seen as a failure of its duty under Article 42(1) of the ICSID Convention which requires that the tribunal "shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable"[55].

While the arbitral tribunal's application of the law applicable to a dispute is generally a question of legal and factual determination rather than a discretion-based determination, there have been some instances where such discretion has been challenged as being in manifest excess of powers. In the annulment proceedings involved in *Wena Hotels v. Egypt*, the respondent-state had contended that the arbitral tribunal had manifestly exceeded its powers in its failure to apply Egyptian law, which was part of applicable law, in determining the rate of interest to be applied on damages[56]. According to the respondent, Article 226 of the Egyptian Civil Code had various limitations on the determination of interest rate which the tribunal had failed to apply. Instead, the arbitral tribunal applied a 9% interest rate compounded quarterly based on its reasoning that compound interest is "generally appropriate in most modem, commercial arbitrations"[57]. In rejecting the respondent's submission, the annulment committee held that international law and ICSID arbitral practice formed a part of the applicable law along with Egyptian law. Therefore, the arbitral tribunal had several alternatives available to it besides Egyptian law governing its decision regarding a suitable rate of interest. The annulment committee further added that it is not up to it to decide whether the arbitral tribunal made the most appropriate choice given in the circumstances of the case, since it amounts to making a decision on merits. Moreover, such decisions of the tribunal are discretionary in nature. Even if it were determined that the arbitral tribunal did not rely on the appropriate criteria, such a finding in itself would not amount to a manifest excess of power leading to annulment[58].

The annulment committee did not consider the tribunal's decision as a failure to apply the applicable law. Rather, the committee felt that decision on interest arose out of the arbitral tribunal's conscious decision to draw from the alternatives available within the applicable law. Characterising it as a discretionary choice whose appropriateness would be a question of merit

[55] Article 42(1) of the ICSID Convention
[56] *Wena Hotels Ltd. v. Arab Republic of Egypt*, Case No. ARB/98/4, Decision on the Application by the Arab Republic of Egypt for Annulment of the Arbitral Award (5 February 2002) para 50
[57] *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4 Award, (Dec. 8, 2000) para 129
[58] *Wena Hotels v. Egypt* (n 56) para 53

rather than procedure, the annulment committee rejected the respondent's request for annulment. Based on the scope of annulment that was identified by the committee, a decision made on the basis of a tribunal's discretion cannot be evaluated on its merit during annulment proceedings. Therefore, even if the annulment committee found such a decision to be incorrect or inappropriate, it could not use that as a basis to a finding of manifest excess of powers by the arbitral tribunal. Alternatively, had the applicable law in the arbitration *solely* been Egyptian law, then the arbitral tribunal's impugned action in this award could have qualified for annulment, as the tribunal would then have been in manifest excess of its powers by its failure to apply the correct law.

The position of the annulment committee in *Wena Hotels v. Egypt* is consistent with other committees such as *CDC v. Seychelles*[59] and *MINE v. Guinea*[60], where it has been held that erroneous application or misapplication of the law, regardless of whether it is based on arbitral discretion, cannot be considered as a case of manifest excess of powers under Article 52(1)(b). The primary concern at the stage of annulment is whether there has been an instance of non-application of the law. However, it must be admitted that this boundary between non-application and misapplication of law may not always be clear. The annulment committee in *MTD v. Chile* quoted the respondent's expert regarding the fact that erroneous application of the law may sometimes be so grave as to effectively amount to non-application of the law[61].

Among the several investor-state disputes that arose out of the Argentine economic crisis of 2001, the *Sempra v. Argentina* award and its subsequent annulment presents a good demonstration of the difficulties involved in drawing distinctions between non-application and misapplication of law. Here, the annulment committee found that the arbitral tribunal's decision to evaluate the respondent-state's defence of necessity as a case where the tribunal had manifestly exceeded its powers[62]. The arbitral tribunal had found that the state of necessity invoked by respondent-state did not meet the customary law requirements as found in Article 25 of the ARSIWA. Holding that the defence of necessity did not preclude wrongfulness, the tribunal in its discretion decided that there was no need to undertake a further judicial review under Article XI of the Argentina-United States BIT, which contained the non-precluded

[59] *CDC Group plc v. Republic of Seychelles* (n 42) para 43
[60] *MINE v. Guinea* (n 44) para 5.04
[61] *MTD v. Chile* (n 1) para 46
[62] *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Decision on Annulment (25 June 2010)

measures provision[63]. The annulment committee was of the opinion that inquiry into necessity under customary international law principles was distinct from the inquiry under Article XI of the BIT. The annulment committee held that by adopting Article 25 of the ILC Articles as the primary law to be applied, rather than Article XI of the BIT, the arbitral tribunal made made a fundamental error in identifying and applying the applicable law[64].

Consequently, the annulment committee held that the tribunal had failed to conduct its review on the basis that the applicable legal norm, which was Article XI of the BIT, and the award was annulled on that basis under Article 52(1)(b). It would seem that the annulment committee here ought to have considered this case as an instance of erroneous application, considering that evaluation of necessity defence under Article 25 of ARSIWA was not incorrect, and that customary principles were part of the applicable law of the dispute. However, the annulment committee was of the opinion that the tribunal's actions, particularly its decision not to address the issue under Article XI, amounted to a non-application of law. Contrasting this decision against previous decisions as well as some other Argentine cases like *CMS v. Argentina*[65] or the *Enron v. Argentina*[66] shows that a bright line rule separating non-application from misapplication of law may not always be possible. The *CMS v. Argentina* annulment committee had refused annulment on a similar issue of the customary law of necessity and non-precluded measures. The annulment committee's refusal to annul the award arose from its opinion that even though it found the tribunal had conflated customary law with non-precluded measures amounting to a manifest error of law, it could not substitute its own opinion on the case with the tribunal's findings[67]. On the other hand, the *Enron v. Argentina* made the opposite finding that rules of necessity and non-precluded measures were indeed interchangeable, and it was up to the tribunal to draw the relationship between the two concepts. While refusing to annul the award on this aspect, the annulment committee granted annulment on a separate issue regarding the tribunal's failure to address the alternate remedies available to Argentina during the economic crisis[68]. While the basic requirement of non-application of the law is the norm among all such proceedings, the nature of the tribunal's underlying decision and the exercise of the

[63] *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (22 May 2007) para 388
[64] *Sempra v. Argentina* (n 62) para 208
[65] *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision on Annulment (25 September 2007)
[66] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Annulment (30 July 2010)
[67] *CMS v. Argentina* (n 65) para 158
[68] Borzu Sabahi, Noah Rubins and Don Wallace Jr., *Investor-State Arbitration* (Oxford University Press 2019) 787

annulment committee's own discretion to annul and its appreciation of the award are relevant factors for an annulment under this ground.

4.2 Serious Departure from Fundamental Rules of Procedure

This ground for annulment due to an arbitral tribunal's serious departure from fundamental rules of procedure is contained within Article 52(1)(d) of the ICSID Convention. This basis for annulment emerges from the rationale of procedural propriety in the arbitral process and fair treatment of the disputing parties. The two crucial requirements for establishing annulment under this ground are: (i) the rules of procedure must be "fundamental", and (ii) the departure of the arbitral tribunal from these rules of procedure must be "serious" in nature[69]. Therefore, mere violation of any of the procedural rules of arbitration would not by its cause an award to be annulled if such as rule is not fundamental. Similarly, even a departure from a fundamental rule of procedure may not be the cause for annulment unless it is serious in nature. Fulfilment of both requirements is necessary for a case of annulment to be considered.

Various annulment committees have defined the contours of the twin requirements of "fundamental rules" and "serious departure". Regarding fundamental rules of procedure, the *Wena Hotels v. Egypt* annulment committee considered to comprise of "a set of minimal standards of procedure to be respected as a matter of international law"[70]. On the other hand, according to the committee, serious departure would constitute such actions of the tribunal as to "deprive a party of the benefit or protection which the rule was intended to provide"[71]. The annulment committee in *MINE v. Guinea* provided its conception of fundamental rules as those procedural rules which protected the right of equal treatment of the parties and the opportunity to fully represent their case[72]. Therefore, the overall rubric under this ground can be conceived broadly as measures that would violate the fundamental principles of natural justice rather than general rules of procedure. According to a report by the ICSID Secretariat, the rules of procedure most commonly considered in regard to the application of Article 52(1)(d) are: the right to be heard, equal treatment of parties, right to an independent and impartial tribunal, the tribunal's deliberation, fair treatment of evidence and burden of proof[73]. Given the high

[69] Schreuer et al. (n 36) 980
[70] *Wena Hotels v. Egypt* (n 56) para 57
[71] Ibid para 58
[72] *MINE v. Guinea* (n 44) para 5.06
[73] ICSID, 'Updated Background Paper on Annulment for the Administrative Council of ICSID' (May 2016) para 99 < https://icsid.worldbank.org/resources/publications/background-papers-annulment>

standard applicable in a case, it is not surprising that annulment proceedings under this ground has rarely been successful[74].

From the perspective of the exercise of arbitral discretion, it can be considered that Article 52(1)(d) is concerned principally with the procedural aspects of such discretion. While the arbitral tribunal has been given abundant flexibility to conduct proceedings under the ICSID Arbitration Rules, this flexibility cannot come at the cost of the fundamental rights of the parties involved in the arbitral process. In this regard, whether a tribunal's actions qualify for annulment under this ground is generally carried out by means of a straightforward review of the conduct of proceedings before the tribunal[75].

In the context of awards on compensation and damages, the treatment of evidence and burden of proof have involved discussions related to the limits of arbitral discretion. Particularly, parties have challenged tribunal decisions on the basis that the tribunal's treatment of evidence on damages as a sign of lack of impartiality and equal treatment. The problem is compounded by the fact that the ICSID Convention does not specify any rules on evidence and Article 34(1) of the ICSID Arbitration Rules provide that the tribunal itself shall be the "judge of the admissibility of any evidence adduced and of its probative value". Some of the earlier instances of annulment proceedings cited actions such as unequal treatment of parties in the allocation of burden of proof[76].

However, annulment committees have made a clear distinction between the tribunal's discretion on the evaluation of evidence and the failure to follow applicable rules of evidence. One such case was of *Wena Hotels v. Egypt*, where the tribunal's determination of the issue of damages and interest rate was also raised as a serious departure from fundamental rules of procedure. As with the ground of manifest excess of powers, as examined above, the arbitral tribunal also rejected the respondent's contentions on both grounds. The annulment committee affirmed the arbitral tribunal's discretion to evaluate the evidence on damages and found that the respondent-state had provided no basis to suggest that the tribunal had manifestly exceeded its discretion in assessing damages[77]. Further, on the tribunal's decision regarding interest rate, the annulment committee found no evidence to support the notion that the arbitral tribunal had

[74] Sabahi et al. (n 68) 789
[75] ICSID, (n 73) para 100
[76] *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on Annulment, (16 May 1986) paras. 90/1; *Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais*, ICSID Case No. ARB/81/2, Second ad hoc Committee Decision on Annulment (17 May 1990).
[77] *Wena Hotels v. Egypt* (n 56) para 65

failed to provide an adequate opportunity to the respondent be heard. It held that both parties had provided "very broad and undetermined positions in respect of the fixing of interest" and were aware of the possibility that the tribunal could have awarded compound interest, following the general practice of tribunals in arbitral proceedings[78]. In *CDC* v. *Seychelles*, the annulment committee held that errors in a tribunal's appreciation of the evidence would not in itself constitute grounds for annulment[79].

In cases where annulment has been granted, the reasons have generally been regarding the denial by the tribunal of the right to be heard in the assessment of damages, as seen in the decisions in *Pey Casado v. Chile*[80] and *TECO v. Guatemala*[81]. The tribunals in both cases had failed to provide the parties an opportunity to make submissions regarding damages. In *Pey Casado v. Chile*, the reason for granting annulment was principally on the ground that the tribunal did not consult the parties regarding the appropriate methodology for assessing compensation due to denial of justice, within the wider standard of fair and equitable treatment[82]. In *TECO v. Guatemala*, the annulment committee found that the tribunal had denied the investor's claim for interest on historical damages on account of unjust enrichment. Neither party had raised claims regarding unjust enrichment, nor could have anticipated that it would be raised in the proceedings[83]. Consequently, the committee found that the tribunal had exceeded the legal framework of the proceedings and the award. The aspect concerning the ruling on interest was therefore annulled.

4.3 Failure to state reasons

The fact that an award has failed to state the reasons on which it is based is available as the final ground for annulment under Article 52(1)(e) of the ICSID Convention. This ground may be considered as a corollary to the requirement to state reasons in ICSID awards under Article 48(3) of the Convention which states that the award shall deal with every question that is submitted to the arbitral tribunal and shall state the reasons on which the decision is based. Within the overall scheme of annulment, the failure to state reasons constitutes the touchstone

[78] Ibid para 69
[79] *CDC* v. *Seychelles* (n 42) para 59-61
[80] *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, ICSID Case No. ARB/98/2, Decision on Annulment (8 December 2012) at para 269
[81] *TECO Guatemala Holdings, LLC v. Republic of Guatemala*, ICSID Case No. ARB/10/23, Decision on Annulment (5 April 2016) at para 184
[82] *Pey Casado v. Chile* (n 80) para 250
[83] *TECO v. Guatemala* (n 81) para 184

for a limited assessment of the reasons furnished by the arbitral tribunal on the grounds of procedure. In other words, Article 52(1)(e) does not permit a review in terms of the merit of the reasons adduced by the arbitral tribunal. As Schreuer and others state in their commentary on the ICSID Convention:

> The duty to state reasons refers only to a minimum requirement. It does not call for tribunals to strain every sinew in an attempt to convince the losing party that the decision was the right one. Even the most earnest and diligent efforts would very often be futile. The duty requires no more than to state reasons sufficient to explain to the parties the motives that have induced the tribunal to adopt its decision[84].

The purported task of the annulment committee is to trace the various steps in the reasoning that lead to the conclusion of those aspects of the award that have been challenged by a party for the tribunal's failure to state reasons. However, if a gap in reasoning are found that lead to a dead-end in terms of understanding the outcome, then it is held that the award has failed to state reasons. As the annulment committee in *MINE v. Guinea* had stated in this regard, the requirement to state reasons is fulfilled when the award enables one to follow how the arbitral tribunal proceeded from Point A to Point B in terms of its reasoning, even if the reasoning is based on an error of fact or law. However, contradictory or frivolous would satisfy the requirement to state reasons[85].

This position adopted by the annulment committee has become part of the standard approach in investor-state arbitration, although the opinion of tribunals regarding the extent of examination of reasons has been varied[86]. At the fundamental level, however, there is a general consensus regarding the fact that two conditions are required to for annulment to be considered: (1) the failure to state reasons has left the decision on a particular point essentially *lacking* in any expressed rationale, and (2) that point must itself be necessary to the tribunal's decision[87]. This implies that reasons that are ancillary to a particular decision cannot be considered as fulfilling the reasoning requirement. Moreover, arbitral tribunals agree that contradictory reasons for a decision is as good as there being no reasons at all. As the annulment committee

[84] Schreuer (n 36) 997
[85] *MINE v. Guinea* (n 44) para 5.09
[86] Tai-Heng Cheng & Robert Trisotto, 'Reasons and Reasoning in Investment Treaty Arbitration' (2009) 32 Suffolk Transnational Law Review 409
[87] *Aguas v. Argentina* (n 49) para 65

in *Klockner v. Cameroon* observed, two genuinely contradictory reasons cancel each other out and is therefore equivalent to there being no reasons at all.[88]

Although the accumulated body of annulment committee decisions reveals a consensus regarding the basic requirements regarding reasons and the consequences of an absolute lack of reasons or contradictory reasons, there has been some degree of divergence among tribunals regarding sufficiency or alternatively, the inadequacy of reasons. Is a mere sequence of reasons behind a decision enough for an award to avoid annulment? Does an annulment committee have the authority to examine the adequacy of reasons? There has been some disagreement among annulment committees regarding such questions that pertain to the scope of review under Article 52(1)(e). Considering the varied implications, it would be useful to briefly consider the principal cases highlighting the divergence among annulment committees. This is particularly relevant considering the fact that there is no guidance to be found regarding the "correct" scope of review of reasons in legal instruments like investment treaties or arbitration rules, including the ICSID Rules.

4.3.1 Scope of the Review of Reasons

As the first instance of an annulment process under the ICSID Convention, the annulment committee in *Klockner v. Cameroon* took upon itself to examine the alleged failure to state reasons in the dispute[89]. On the question of whether the scope of review under Article 52(1)(e) allowed the committee to examine the inadequacy of reasons contained in the arbitral award, the committee held that the reasons on which an award is based must be "sufficient". However, the committee warned against approaching the condition of sufficiency with such rigor that annulment process would not end up as an appeal[90].The committee further added that it was not enough for the reasons to be formal and apparent but should "allow the reader to follow the tribunal's reasoning on facts and on law."[91] It then settled on the notion that the reasons in an award should be "sufficiently relevant" or "reasonably acceptable" in order for the award to avoid annulment for failure to state reasons. Proceeding on this basis, the annulment committee thoroughly examined the reasons adduced in the arbitral award and concluded that the tribunal

[88] *Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais*, ICSID Case No. ARB/81/2, Decision of the Ad Hoc Committee (3 May 1985) at para 116
[89] Ibid para 82
[90] Ibid para 118
[91] Ibid para 119

had failed to account for some of the arguments presented by the claimant-investor. On the particular issue of quantum, the annulment committee could not find any legal reasoning that fulfilled the requirement to state reasons in terms of how the annulment committee's interpretation of reasons. Instead, the committee found that the arbitral tribunal had resorted to equitable estimates while calculating damages[92].

Based on these findings, the *Klockner* annulment committee held that the arbitral award must be annulled. This particular decision can be said to have established a high threshold for the review of reasons during annulment proceedings[93]. Additionally, the committee expressed its dissatisfaction with "equitable estimates" regarding the value of the obligations and debts arising in the dispute instead of legal reasoning. The arbitral award that was made in this regard did not pass the test of sufficient relevancy in terms of reasons. Despite the plausibility of the committee's reasoning for a high threshold, its decision came under severe criticism from commentators at the time and after. The principal point of criticism was not with the creation of a "sufficiency" standard for reasons, but the manner in which the *Klockner* committee had carried what amounted as to a substantive evaluation of reasons.[94] Even though it had warned against mixing appeals with annulment, the committee had effectively conducted a qualitative review of the various reasons provided in the award, rejecting those that it did not consider to be good reasons.

A diametrically opposite position to that of the *Klockner* decision was developed a few years later by the annulment committee in *MINE v. Guinea*[95]. The annulment committee took a narrower interpretation of the scope of Article 52(1) than *Klockner* based on its opinion that annulment was a limited remedy. Consequently, the committee here took a low-threshold approach to the requirement of reasons. It recorded its observations in this regard as follows:

> The Committee is of the opinion that the requirement that an award has to be motivated implies that it must enable the reader to follow the reasoning of the Tribunal on points of fact and law. It implies that, and only that. The adequacy of the reasoning is not an appropriate standard of review under paragraph (l)(e), because it almost inevitably draws an ad hoc Committee into an

[92] Ibid para 176
[93] Cheng and Trisotto (n 86) 415
[94] W L Craig, 'Uses and Abuses of Appeal from Awards' (1988) 4 Arbitration International 3, 174–227. Aaron Broches, 'Observations on the Finality of Awards' (1991) 6 ICSID Review 2, 325
[95] *MINE v. Guinea* (n 44) para 4.04

examination of the substance of the tribunal's decision, in disregard of the exclusion of the remedy of appeal by Article 53 of the Convention[96].

For the *MINE* committee, the ability to follow from the award how the tribunal went from Point A to Point B and the eventual conclusion was enough to fulfil the requirement to state reasons, and the fact that there might be errors of fact and law in the reasoning was immaterial for the purpose of annulment proceedings. Although critiqued initially, this approach of placing a minimum requirement on the tribunal gained acceptance among several subsequent annulment committees[97]. Besides the contrasting positions taken in the *Klockner* and *MINE* decisions, some alternative approaches sought to take a middle path in terms of the scope of Article 52(1)(e). For instance, the annulment committee in *Soufraki v.UAE* in considering prior annulment decisions and the consideration of "sufficient reasons" to develop a more nuanced view[98]. While agreeing with the *Klockner* committee's original position that sufficiency and adequacy of reasons is a relevant consideration, the *Soufraki* committee opined that annulment committees must seek to find a balance between the opposing considerations of finality of awards and correctness of decisions while evaluating such reasons. It added that a lack of references or legal and factual elaborations of reasons did not render reasons to be insufficient. In the committee's words, "so long as those reasons in fact make it possible reasonably to connect the facts or law of the case to the conclusions reached in the award, annulment may appropriately be avoided"[99].

Despite a diversity of approaches prescribed, the practice among annulment committees largely settled around the "minimum requirement" approach as set out by the *MINE v. Guinea* decision, to the extent that it is also applied as a statement of principle.[100] Although a certain degree of heterogeneity still exists and some annulment committees continue to take a more nuanced approach, it may be concluded that most committees do not seek a review of the substantive correctness of the reasons stated in the arbitral award. In this context, the findings of the annulment committee in *Aguas (Vivendi) v. Argentina* provides an apt conclusion with its view on the discretion that is allowed to arbitral tribunals in setting out the reasons in the arbitral award. The committee here largely followed the *MINE* decision while stating that:

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[96] Ibid para 5.08
[97] Cheng and Trisotto (n 86) 416.
[98] *Hussein Nuaman Soufraki v. The United Arab Emirates*, ICSID Case No. ARB/02/7, Decision on Annulment (5 June 2007)
[99] Ibid para 131
[100] Charalampos Giannakopoulos, 'Reconceptualizing 'Failure to State Reasons' as a Ground for Annulment under Article 52(1)(e) of the ICSID Convention' (2017) Journal of International Dispute Settlement 8, 125

> Provided that the reasons given by a tribunal can be followed and relate to the issues that were before the tribunal, their correctness is beside the point in terms of Article 52(1)(e). Moreover, reasons may be stated succinctly or at length, and different legal traditions differ in their modes of expressing reasons. Tribunals must be allowed a degree of discretion as to the way in which they express their reasoning.[101] (emphasis added)

Having thus considered the varied reasoning standards against annulment, it would be useful to provide a conclusive picture on the scope of review of discretion-based decisions by annulment committees when such decisions subjected to challenge under Article 52(1)(e).

4.3.2 Discretion and the review of reasons

From the various decisions on annulment on the grounds of failure to state reasons that have been discussed so far, it may be observed that the requirement to give reasons acts as a limited constraint against the manner in which arbitral tribunals make decisions. In fulfilling the reasoning requirement, arbitral tribunals are constrained to from making decisions that are in contradiction to the facts and legal issues that are involved in a given dispute. This requirement to give reasons is not unique to ICSID arbitration alone but is present in other arbitral systems, including commercial arbitration[102]. Under the UNCITRAL Arbitral Rules, a similar requirement to state reasons in the award is provided, though parties have the option to agree to dispose of the requirement[103].

In acting as a constraint against errant decision-making, the requirement to state reasons and its consequent risk of annulment acts also constrains arbitral discretion to a limited extent. Where a tribunal decides to make discretionary choices, it must explain the reason for such choices and the basis on which they were made. However, the degree to which a subsequent annulment committee can review these choices is admittedly limited. Annulment as a post-award remedy is inherently a procedural remedy, which does not aim to provide an appellate function. Although some annulment committee have attempted to widen the scope for review of reasons through formulations of "sufficiency" and "adequacy", the standard of enquiry is limited to checks on coherence and procedural propriety, rather than any form of qualitative assessment.

[101] *Aguas v. Argentina* (n 49) para 64
[102] Roman Prekop and Peter Petho, 'The Standard of Reasoning in Arbitral Award' (2018) 8 Czech (and Central European) Yearbook of Arbitration 157; Peter Gillies and Niloufer Selvadurai, 'Reasoned Awards: How Extensive Must the Reasoning Be?' (2008) 74 Arbitration 125
[103] Article 34(3) of the UNCITRAL Arbitration Rules 2010

Decisions that are largely or partially discretionary in nature are not treated as a any special sub-categories, but broadly as 'decisions'. From the point of view of the annulment committee, it is irrelevant whether a decision has been made on the basis of the tribunal's discretion or on the basis of factual-legal considerations so long as such decisions are supported by reasons that can be reasonably discerned from the arbitral award.

Throughout the present thesis, we have encountered several arbitral awards where subsequent annulment committees have had to examine challenges made specifically against discretionary decision-making in damages awards –

Enron v. Argentina[104] (annulment committee cannot second guess tribunal's exercise of discretion, unless it breaches fundamental rules of procedure); *Wena Hotels v. Egypt*[105] (arbitral tribunal's discretion in determining the rate of interest); *MTD v. Chile*[106] (arbitral tribunal's margin of estimation in apportioning contributory fault); *UAB Energija v. Latvia*[107] (arbitral tribunal's discretion in apportioning contributory fault); *EDFI v. Argentina*[108] (arbitral tribunal's discretion in apportioning for failure to mitigate); *Rumeli Telekom v. Kazakhstan*[109] (tribunal's discretion on quantum assessments); *Azurix Corporation v. Argentina*[110] (tribunal's discretion in quantifying damages).

In all of these annulment decisions, challenges on the ground of failure to state reasons, as well as other grounds under Article 52(1) were considered. In none of these decisions, however, the tribunal's exercise of discretion was held as defective for failure to state reasons. At a broader level, annulment committees in each case made clear their deference to the wide discretion of tribunals over various issues on quantum. It would be proper to conclude with regard to these decisions that the general policy of tribunals is not to enquire into the basis of discretion, as long as at least some reasons can be discerned from the face of the award.

Despite this broader tendency of deference among ICSID annulment committees, there are a few notable cases where the impugned decisions made on a discretionary basis were annulled

[104] *Enron v. Argentina* (n 66) para 192
[105] *Wena Hotels v. Egypt* (n 56)
[106] *MTD v. Chile* (n 1)
[107] *UAB Energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Decision on Annulment (8 April 2020)
[108] *EDFI v. Argentina* (n 48)
[109] *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Decision of the Ad-Hoc Committee (25 March 2010)
[110] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Decision on the Application for Annulment of the Argentine Republic (1 September 2009)

due to the finding of failure to state reasons. While the annulment committees in these decisions indicated their general affirmation of the tribunal's margin of discretion, it was held that such exercise of discretion could not run afoul of the requirement to state reasons.

In *Pey Casado v. Chile*, the annulment committee was called upon to annul a portion of the award on damages due to the arbitral tribunal's failure to state reasons for the methodology and calculations used in assessing the quantum of damages[111]. In particular, the respondent-state submitted that the arbitral tribunal had failed to explain why the full reparation standard was the right standard for compensating the claimant-investors due to alleged denial of justice and the breach of fair and equitable treatment standard of the Chile-Spain BIT. Further, it was alleged that the tribunal had failed to explain why to meet this standard, an amount accounted from on expropriation-based compensation (that was used in a related decision) ought to be applied here[112]. The claimant did not address this particular challenge in its submissions.

The annulment committee agreed with the principle placed by the claimant that "contradictory reasons amount to a failure to state reasons", which has also been discussed above. The committee went on to find that the tribunal had made the error of providing contradictory reasons: on one hand, the tribunal had held that the evaluation of damages suffered by the claimant-investors due to expropriation was irrelevant to the case and would not be considered by the tribunal, given that the expropriation had occurred before the BIT came into force[113]. On the other hand, the tribunal proceeded to determine the calculation of the Claimants' damages on the basis of the evaluation that had been made earlier by the respondent-state for the purpose of compensation arising from its act of expropriation. In deciding to annul this portion of the award for failure to state reasons, the annulment committee observed:

> While the Committee recognizes that arbitral tribunals are generally allowed a considerable measure of discretion in determining quantum of damages, the issue in the present case is not per se the quantum of damages determined by the Tribunal. Nor does the problem lie per se in the Tribunal's chosen method of calculating the damages suffered by the Claimants. The issue lies precisely in the reasoning followed by the Tribunal to determine the appropriate method of calculation, which, as demonstrated above, is plainly contradictory[114].

[111] *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, ICSID Case No. ARB/98/2, Decision on Annulment (8 December 2012) para 278
[112] Ibid para 279
[113] Ibid para 283
[114] Ibid para 286

This is an important statement with respect to the connected issues of arbitral discretion and the requirement to state clear and coherent reasons. Even though the discretion of tribunals is well-recognised in the context of assessment of damages, including the method of assessment, the tribunal is constrained in its exercise of discretion by the requirement that it must provide clear and non-contradictory reasons that support and explain the discretionary decision. Thus, while the annulment committee in this case found no problems with the amount of damages or the method of valuation, the fact that it provided contradictory reasons for its choice of valuation method proved fatal for the award. For a reasonable reader, it is not possible to reconcile the tribunal's contradictory reasoning leading to the damages award. It is therefore a procedural error rather than a substantive fault that led to the annulment of the portion of the award on damages.

A similar instance of procedural constraint against the exercise of arbitral discretion occurred in the decision on annulment in *Tidewater v. Venezuela*[115]. As in the *Pey Casado* decision, here too the respondent-state sought annulment of the award due to the arbitral tribunal's contradictory reasoning. The respondent alleged that the tribunal had established the elements for calculating the market value of the claimant-investor's business for deciding compensation out of lawful expropriation. However, the tribunal allegedly fixed the compensation amount in contradiction to the elements that it had established[116]. The annulment committee consequently began its analysis with the delineation of the principle regarding the requirement to state reasons:

> An award is not a discretionary fiat but the result of the process of weighing evidence and applying and interpreting the law and subsuming the facts thus established under the law as interpreted by the Tribunal. The legitimacy of the process depends on its intelligibility and transparency. The statement of reasons allows the Parties to understand the process through which the tribunal makes its findings[117].

The arbitral tribunal quite evidently cannot make an award on a purely discretionary basis. The presence of reasoning and reasons are both essential to the making of the award and towards ensuring its legitimacy[118]. Thus, an arbitral award that is inflicted by a lack of reasons or reasons

[115]*Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Annulment (27 December 2016)
[116] Ibid para 161
[117] Ibid para 163
[118] Sean Stephenson, Quantum and Reasons in Investment Treaty Arbitration: The Next Reasoning Frontier? *ICSID Review* (2021) at 3

that are contradictory to each other cannot be said to satisfy the requirement of reasons required under the ICSID Convention. In this regard, the annulment committee added that not all forms of contradictory reasons may lead to annulment, but only those that cancel each other out may qualify as failure to state reasons. In the same manner in which the annulment committee clarified that it had no authority to review the correctness of reasons, it is not permitted for it to consider the correctness of the arbitral tribunal's use of its discretion. Doing so would imply that the committee was substituting the arbitral tribunal's interpretation and discretion with that of the committee's own discretion[119]. Consequently, the any review of discretion would be limited to a procedural review of the reasons provided by the tribunal and whether such reasons enable the disputing parties and the annulment committee to understand the process leading to the outcome.

In assessing the contentions of both parties, the annulment committee found that the tribunal had contradicted its own reasoning at the stage of calculation of damages. The tribunal had determined specific rates for the elements that would constitute its DCF-based calculation: sources of cash flow (15 vessels), unpaid accounts receivable (~16.48 million USD) and country risk premium (14.75%). However, the tribunal subsequently adopted a valuation that accounted for only 11 vessels and applied a country risk premium of 1.5%. The considerable difference between the amount of compensation that arose, according to the annulment committee, rose directly from the tribunal's own contradictory reasoning. The discretion that was invoked by the tribunal in settling the final amount of compensation could not be sustained on the face of clear contradictory reasoning. Consequently, the award was partially annulled for failure to state reasons, arising from purely contradictory reasons. The committee observed that while it could not annul an award for reasons of errors in the use of arbitral discretion, it could consider annulment where the discretion was exercised without stating the reasons [120].

Both *Pey Casado* and *Tidewater* annulment decisions have provided important insight into the limits of arbitral discretion, particularly on ground of the reasoning requirement and its subsequent failure as a subject of annulment. Annulment committees have sought to maintain a clear distinction between an assessment of procedural consistency in the use of discretion and evaluation of the *correctness* of the use of discretion in terms of the scope of review. While the former is well within the annulment committees authority, the latter would exceed such authority. It must also be noted that reasoning itself is a necessary element to any actions arising

[119] *Tidewater v. Venezuela* (n 115) para 172
[120] Ibid para 196

from discretion. Without reasons that can connect the decision-making process to the outcome, an ICSID award will be liable to be annulled.

4.4 Summary

The survey of the ex-post measures for controlling against excessive or defective use of arbitral discretion has led some interesting findings regarding the manner of operation of ICSID arbitration. While annulment remains the principal tool against decisions that involve an abuse of discretion, the mechanism for controlling such decisions is completely procedure oriented. The annulment mechanism makes its distinction from appellate process clear. It is not concerned with a substantive review of the arbitral award but aims to address a wide range of procedural faults that may underpin "bad" decisions. Consequently, the reach of ICSID annulment as a corrective mechanism is limited. Awards that may contain fundamental errors of fact or law cannot be corrected in this process. Additionally, none of the grounds for annulment impedes the use of arbitral discretion. As several annulment committees have clarified over the years, arbitral tribunal are allotted with wide discretion to make decisions regarding any aspect of the damages award. Whether the tribunal makes errors in this process is not the annulment committee's concern, as long as the tribunal does not violate fundamental procedural safeguards. Where the tribunal exceeds the legal framework developed by the parties and exceeds the limits of its powers, the annulment process comes in to act as a corrective mechanism. Despite a wider consensus among annulment committees regarding the scope of their powers, there are some aspects, such as with the understanding of manifest excess of powers or the extent of review under the reasoning requirement that has led to some divergence among annulment committees. While an argument could be made for a higher standard of procedural control as a means for increased coherence and reduced inconsistency in the ISDS system overall, the ICSID system currently provides the only avenue against further divergence and fragmentation of arbitral jurisprudence.

5. Conclusion

This chapter dwelled on the effects of the improper use of arbitral discretion in terms of the increased fragmentation of arbitral awards on damages. The particular issues of incoherence and inconsistencies that are systemic issues to investor-state arbitration may be worsened by high-value awards on quantum that are inadequately reasoned, or which seek to bypass coherent reasoning by invoking discretion. Due to the sustained problems of incoherence and inconsistencies in arbitral jurisprudence and concerns with decision-making, countries around the world have become active participants in multilateral efforts towards procedural reform of ISDS as well as by treaty-based reform measures. Turning to the question of specific remedies that are currently available in the arbitral system, the various grounds for annulment of awards on quantum have been discussed as the form of remedy that addresses the problems arising from tribunal reliance on discretion in the decision-making process.

The ICSID annulment process is provides for a variety of grounds for review of arbitral awards, though any such review is limited to examination of procedural propriety. As the opposing policy goals of finality and correctness in arbitration are difficult to reconcile, the process of annulment performs a balancing act by allowing a limited exception to the finality of the arbitral process. The scope and limitations of the various grounds of annulment have also undergone a significant period of evolution, with various annulment committees providing a range of perspectives on what the right extent of review under the annulment process should be. On the particular issue of arbitral discretion, the grounds examined in the chapter indicate that annulment committees have frequently faced situations where a more structured understanding of the so-called wide discretion of arbitral tribunal has been made necessary. Although the arbitral system does not permit a revaluation on the merits of the system, including the use of arbitral discretion, various decisions have sought to develop a consistent position that limits arbitral discretion by way of placing the requirement of clear and coherent reasons in support of the exercise of discretion, which would allow parties to understand the process by which the tribunal reached its decision, even though such decision may be termed to be erroneous or incorrect. Considering the necessity of arbitral discretion in any dispute settlement process, the system of limited ex-post review made available under the ICSID process constitutes a corrective mechanism that avoids the necessity of a full-fledged appeal.

Chapter 6

General Conclusions

Having considered at length the multi-stage process of assessment of quantum and the role of arbitral discretion therein, it has become possible to make some conclusions regarding the principal propositions made in this thesis. It is quite evident that arbitral discretion plays a critical role in the making of an award on compensation or damages, although the scope of this discretion varies on the basis of the type of assessment being made. The very concept of the discretionary authority of arbitral tribunals emerges from some of the fundamental building blocks of the arbitral process: the agreement to arbitrate, the rules governing the arbitral process and all other mandatory rules that cannot be derogated from by the will of the parties. Thus, it is the arbitral process itself that necessitates and enables the exercise of discretion as a specific power of the arbitral tribunal. Because laws and rules are never perfectly complete, arbitrators have to necessarily resort to their discretion in order to successfully navigate the arbitral process and arrive at an outcome that satisfies the arbitral mandate of dispute resolution. Beyond these general notions, arbitral discretion has a particularly important function in the context of treaty or contract-based foreign investment arbitration. The manner of construction of the general agreement to arbitrate within international investment law, as examined in Chapter 2, provides some preliminary indications as to why a significant degree of discretion is generally assumed by investor-state tribunals. The broad construction of investment treaty standards and the tendency of most procedural rules of arbitration to defer to the tribunal's authority contribute to the varying notions of procedural and substantive discretion. In the specific context of compensation and damages assessments, discretion gains even more fluidity in order to help the tribunal fill interpretive gaps and make determinations under the shadow of relative uncertainty. Tribunals upon tribunals have therefore opined as to why the assessment of quantum is not an exact science and a significant assumptions and estimates are built into the process of finding the appropriate sum of money which the respondent must compensate the claimant. The varied considerations for tribunals involve not only the impugned actions of the disputing parties but also the nature of the parties in dispute.

This thesis sought to examine the manner in which tribunals make use of discretion in assessing compensation and damages. Chapters 3 and 4 together provide a comprehensive assessment of how invocations and application of discretion is manifested in the different stages of determination, beginning with the legal principles defining and delimiting the scope of compensation and monetary damages under international law. Approaching the issues sequentially allowed the thesis to draw out the limits of legal and financial principles and the space for considerations of equity, fairness and reasonableness therein, all of which are incorporated into valuations by the exercise of the arbitral tribunal's discretion. Although the process of valuation has become increasingly sophisticated over the years and arbitrators spend a lot of time and effort towards making precise determinations, the role of equitable considerations has not been driven away completely. Even in the use of advanced methods for valuing investments, discretionary decision-making plays an important role in setting the right inputs for assessment and exerting control on the overall process against excessive speculation. Therefore, instead of concerns about the diminishing role of the arbitrator, it could rather be said that the arbitrator's role has become more prominent towards achieving a fair outcome in the determination of awards on quantum. This is apparent not only during the process of 'building up' to the investment value (Chapter 3), but possibly even more during the application of reduction and other forms of adjustments to value (Chapter 4). In fact, on issues that impugn the claimant-investor's responsibilities and their impact on quantum, the approach of tribunals is almost completely guided by arbitral practice that has developed over time. Even in the absence of a centralised structure, investor-state tribunals have displayed remarkable towards building consensus on how factors affecting the final sum of compensation or damages are given effect that protects procedural integrity as well as the legitimate rights of parties.

The use of arbitral discretion, however, is not without its associated problems. The two principal points of criticism that explored in this thesis were those of divergence in the application and interpretation of legal and financial standards governing quantum issues as well as inadequate reasoning in support of discretionary decision-making. Both sets of problems contribute to the broader critiques of inconsistent arbitral decision-making that has eroded the legitimacy of the arbitration model for settlement of investor-state disputes. In light of the various proposals suggesting alternatives to arbitration, the thesis explored the principal process of exerting control against errant cases of misuse of discretion. Presently, the annulment process provided under the ICSID Convention is the only means for reviewing

the integrity arbitral awards on limited procedural grounds, within which arbitral decision-making has been the subject of several annulment proceedings, as reviewed in Chapter 5. However, the extent of review against alleged misuse of discretion rests on limited procedural grounds, which includes instances of tribunals exceeding their authority, deviating from fundamental rules of procedure or failure to state reasons as grounds for annulment of awards. While there has been a mixed record in terms of the success of claims that impugn excessive or defective use of discretion, the ICSID annulment mechanism provides many useful indicators on how discretion is perceived by the users and practitioners of arbitration. Considering that institutional alternatives to arbitration that provide dispute settlement will likely also have to contend with discretionary decision-making, the findings in this thesis will provide stakeholders with the knowledge and insight necessary to tackle arbitrariness or indeterminacy arising in dispute settlement processes.

The key findings of each chapter in the thesis may thus be broadly summarised as follows:

1. This thesis has demonstrated the pervasiveness of arbitral discretion in the decision-making process of investor-state tribunals in the context of assessment of compensation and damages. Some form of discretion is exercised at every stage of the chain of determinations involved in such issues of quantum, with the presence or absence of applicable legal and accepted financial principles determining the extent to which discretion may be exercised.
2. In chapter 2, the roots of the arbitral tribunal's power to exercise discretion were evaluated to find that the expression of consent by state parties to investment treaties and the resulting agreement to arbitrate is the primary source of the arbitral tribunal's authority, including its discretionary authority. Further, procedural rules and *lex arbitri* are crucial factors that shape the contours of discretion. Discretion itself is not as amorphous as a concept as believed. Considerations of natural justice, including equity, reasonableness and fair treatment of disputing parties have animated the exercise of discretion on both substantive and procedural issues in arbitration and act as natural mechanisms constraining the reliance on and the use of discretionary authority.
3. In chapters 3 and 4, all of the principal stages and key considerations involved in the assessment of compensation and damages claims in investor-state disputes have been evaluated in context to the use of discretion. It has been demonstrated that determinations on quantum are not always guided by extensive rules and guidelines,

with arbitral tribunals frequently resorting to informed discretion in making key determinations. Greater the degree of uncertainty involved at any stage of determination, the more likely that discretion will be relied on to some degree. However, observations have also been made regarding the use of discretion as a means of bypassing the requirement of stating reasons for a decision in hard cases. The extent of reasoning behind discretionary decision-making varies greatly from case to case.

4. Finally, in chapter 5, the key consequences of the misuse of discretion were examined by framing the problem in terms of inconsistency and incoherence in arbitral decision-making, leading to an erosion in the legitimacy of international arbitration. The key remedy of annulment was discussed in terms of the various grounds available under the ICSID Convention by which a limited degree of control is exercised against the misuse of discretion. Tying the problem of lack of reasoning in awards with divergence in decision-making, the scope of procedural review under Article 52(1) of the ICSID Convention was examined. In its present form, the annulment mechanism is able to address a particular sub-set of cases where discretion is exercised but in the absence of reasons to justify its use or when the reasons adduced are completely contradictory to each other.

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