Ninth Investment Arbitration Forum: Valuation of Damages in Changing Economic and Political Circumstances

Kluwer Arbitration Blog
July 1, 2018

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Please refer to this post as: Katharina Plavec, 'Ninth Investment Arbitration Forum: Valuation of Damages in Changing Economic and Political Circumstances', Kluwer Arbitration Blog, July 1 2018, http://arbitrationblog.kluwerarbitration.com/2018/07/01/ninth-investment-arbitration-forum-valuation-damages-changing-economic-political-circumstances/

On 26 May 2018, the **Ninth Investment Arbitration Forum** took place at the Juridicum of the University of Vienna jointly organized by Prof. Irmgard Marboe of the University of Vienna, Adriana San Román and Herfried Wöss of Wöss & Partners and ICC Austria. The topic of this year's forum was **"Valuation of Damages in Changing Economic and Political Circumstances"** and to what extent lessons learnt in Latin America were relevant for investment arbitration in Europe. The conference was preceded by the ICC Austria Advanced Seminar on Damages in International Arbitration and aimed at analysing discrete key damages and valuation issues in investment arbitration.

Mexico's Accession to ICSID and ICSID Reform

The conference warmed up with brief reports on two important developments: (i) the accession and ratification of Mexico of the ICSID Convention, and (ii) the ongoing ICSID Reform. The first was addressed by his Excellency Ambassador Hermann Aschentrupp Toledo, deputy-head of mission of the Embassy of Mexico in Austria, who gave an overview of the history of investment protection and the current situation in Mexico, stressing that Mexico is one of the most active countries in the use of dispute settlement mechanism and seeks to strengthen its position as a safe, reliable and attractive country for investment. With respect to the second, Corinne Montineri and Judith Knieper of UNCITRAL gave an overview of ISDS Reform starting with the UNCITRAL Transparency Standards and continuing with the Working Group III mandate to consider possible ISDS reforms to respond to criticism and to perform a thorough review of issues and perspectives.

Lessons learnt in Latin America?

In the first panel Prof. Guillermo Estrada Adán of the Instituto de Investigaciones Juridicas/UNAM, moderating Diego Brian Gosis (GST LLP), Michael Kotrly (Freshfields), Diego Cadena (Foley Hoag) and Herfried Wöss (Wöss & Partners), raised the question whether there were lessons to be learnt from Latin America. Addressing investment cases filed against Argentina on the basis of BITs after Argentina's abandonment of the peso-dollar parity, Diego Brian Gosis showed how these cases led to different outcomes, despite dealing with the same measures. Michael Kotrly referring to Chavez' "Bolivarian revolution" asked whether a higher risk of expropriation should be considered in the calculation of damages and presented various cases involving Venezuela from recent years which addressed the issue. He examined whether the existing case law is reconcilable and how precisely

expropriation risk can be accounted for.

Diego Cadena introduced Ecuador's struggle with foreign investors in the petroleum industry referring to a windfall tax set at 50% and later augmented to 99%. The Tribunal in Murphy found that the 50%-tax did not breach claimant's legitimate expectations, but that it did constitute a violation when applied at 99%. He mentioned that the Tribunal did not determine any other "outer tolerable limit" which leads to uncertainty as regards the damages determination and concluded that one should rely on the objective data reasonably obtained by the investor when placing its investment and not on the picture of the ongoing business.

Referring to the same case, Herfried Wöss raised the issue of how different findings of liability would impact damages under the notion of but-for causality. In *Murphy v. Ecuador*, the Tribunal considered the second tax increase as violating FET, whereas *Burlington v. Ecuador* found illegal expropriation leading to a total deprivation of the investment. The Tribunal in Murphy awarded damages for the impact of the second tax increase on its cash flows for the whole contract term. The Tribunal in *Burlington* considered that the investment was the bundle of contractual rights and obligations which lead to a re-integration of the lost past and future cash flows under the but-for scenario applying the contractual tax-absorption clause. He mentioned that *Burlington* is worth reading for its clear and detailed reasoning and the precision of the application of the but-for premise.

Changing economic and political circumstances and their effects on damages

Professor Nikos Lavranos of Wöss & Partners and Smaranda Miron of the Energy Community secretariat moderated Prof. Irmgard Marboe (University of Vienna), Alejandro Carballo Leyda (Energy Charter Secretariat), Adriana San Román (Wöss & Partners) and Bernardo V. Preziosi (Curtis, Mallet-Prevost, Colt-Mosle) covering a broad range of discrete topics:

Stressing the difference between lawful and unlawful expropriation, Irmgard Marboe pointed out that the sovereign right to expropriate was solidly based on public international law, but that several conditions had to be met. She focused in particular on the relevance of the payment of compensation. While expropriations were sometimes deemed lawful even though no compensation was paid, in other cases, expropriations were considered unlawful seemingly only because of a lack of compensation. A closer analysis, however, led her to the conclusion that the requirement of due process was in fact the decisive criterion for distinguishing between lawful and unlawful expropriations.

Alejandro Carballo Leyda raised the question of whether changing economic circumstances would be considered under the Energy Charter Treaty, for example pursuant to Art 24.3.a.II ECT (measures necessary in time of war or other emergency in international relations) and Art 24.3.c ECT (maintenance of public order). He concluded that such measures could neither have an effect equivalent to expropriation nor affect the transit or the obligation to compensate for losses. The ECT did not expressly include specific temporary safeguard measures in case of exceptional balance-of-payments difficulties.

Adriana San Román (Wöss & Partners) compared the measure of damages between commercial arbitration and investment arbitration using as examples prominent gas and oil cases such as *Bridas v. Turkmenistan* and explained how the notion of the hypothetical course of events under the *Chorzów* formula and the FMV measure of damages ignores extraordinary economic circumstances, which affects the damages to be awarded. Finally, Ms. San Román addressed recent criticisms of the *Chorzów* formula and ended posting the following questions: Would states not take advantage of investors if there were no full reparation principle and would it not be important to establish a balance between states and investors in order to avoid opportunistic behaviour of states? Would the expropriation risk and the costs of projects not increase by discarding *Chorzów*? Would discarding the

Chorzów formula result in less investments?

Benard V. Preziosi (Curtis, Mallet-Prevost, Colt-Mosle) discussed the effect of contractual limitations on damages in investment arbitration on the basis of Mobil v. Venezuela which establishes that a claimant is only entitled to be compensated for the investment it made. International law protecting that investment does not expand the property rights constituting the investment or eliminate conditions or limitations imposed on the investment by national law at the outset that might impact compensation in the event of later adverse governmental measures. Such conditions and limitations are part of the scope of the investment defined by national law and must be given effect in the calculation of compensation.

Recent developments of investment arbitration in Europe and Latin America

In the next panel (moderators: Dr. Elisabeth Vanas-Metzler, VIAC, and Emmanuel Kaufman, Knoetzl) Antolín Fernández Antuña (State Attorney's Office, Spain) presented a valuation analysis of various renewable energy cases against Spain. He stressed that the fact that renewable energy plants such as solar plants and wind parks need high subsidies should be taken into account when valuating damages.

Anne-Karin Grill (Vavrovsky Heine Marth) argued that the FMV rationale should not apply to breach of contract cases under umbrella clauses contained in international investment agreements where international legal standards such as the FET standard are not violated and there is no international tort but only a breach of contract protected by the umbrella clause. Rather, one should apply the principle of full reparation of the actual loss through the but-for premise which would lead to market value taking into consideration the prevalent economic circumstances in both the actual and the but-for scenarios.

According to Professor Stefan Weber (Weber & Co) reliance damage is also recoverable in case of a bad business unless the lack of profitability of the investment is proven. The risk of overcompensation (if an investor is compensated for investment that would not pay off in the absence of the breach of contract) might be avoided by means of causation. In this respect the burden of proof and the standard of proof play an important role.

Professor Christoph Schreuer (zeiler.partners/University of Vienna) discussed the consequences of the ICSID denunciations by Bolivia, Ecuador and Venezuela. According to Schreuer's interpretation of Articles 71 & 72 of the ICSID Convention, rights and obligations based on consent, including the participation in proceedings, remain unaffected by the 6-month period in Art. 71 and will continue indefinitely. Other rights such as participation in the administrative council and the nomination of persons on the board of arbitrators continue only for six months. He concluded that despite the denunciations, the number of arbitrations is likely to rise.
The view of economic and financial experts

The conference ended with a roundtable of prominent financial experts under the moderation of Adriana San Román. Addressing the EU's Renewable Energy Source (RES), Anton Garcia (Compass Lexecon) mentioned that in order to achieve the EU's RES deployment, Member States introduced incentives for investors in the form of support schemes, protected from revision by EU Law. Despite this, some states implemented cuts to the support of existing plants. Mr. Garcia argued that DCF, arguably the most widely accepted method for the valuation of damages, is particularly well-suited to value damages in the ensuing arbitrations given the high predictability of cash flows of RES plants. Alternative ad hoc-valuation approaches or asset-based methods do not provide a better alternative.

With respect to differences between damages valuation and company valuation, James Searby (FTI Consulting) explained that damages valuation differs from company valuation as the date of valuation is often in the past, resulting in less certainty. The introduction of counterfactuals, or but-for scenarios, and the need to take account of mitigation introduce further uncertainty. As an alternative to FMV he proposed to use “investment value”, asking what the investment is worth in the hands of the actual owner, before moving to an approach that assumes a transaction between “typical market participants”.

As to the role of hindsight information, Tomas Haug (NERA) examined whether an ex ante or ex post approach is preferable from an economic perspective. He examined unbiasedness (whether risk-neutral agents would be indifferent or whether one approach always leads to over-/ undercompensation of plaintiffs), efficiency (whether neither approach leads to a negative change in behaviour) and practicality (whether one approach increases objectivity). He concluded that there are good arguments for both regimes from an economic standpoint.
Finally, Thierry J. Senechal (Finance for Impact) held his presentation on the time value of money in damage valuation. According to this theory, the delay between the time the injury occurs and the rendering of the arbitral award should be taken into account. While the question of the applicable interest rate is hard to answer due to a lack of a universally accepted standard, there is agreement that a compound interest rate should be used for pre-award interest.

Conclusion and Comments

Recent case law shows a growing sophistication in damages analysis and valuation reflected by high-level contributions also in the academic and professional fields in which the conference’s co-chairs have significantly taken part. However, there are still areas that have not (compensation for a bad business) or only recently (the role of contractual limitations) been tackled in the context of investment cases. The Ninth Investment Arbitration Forum aimed to be thought-provoking in this respect. It also showed that the measure of damages, causality, hindsight and other notions of international damages law leading to “what has to be calculated” are in essence legal questions which require counsel and arbitrators to precisely define their instructions to the financial experts.