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Interest Rate Trends in Investor-State Disputes in 2022-2023

Shay Lakhter (International Centre for Settlement of Investment Disputes (ICSID)) · Wednesday, March 27th, 2024

In the commentary to the ILC draft Articles on State Responsibility it is suggested that interest is not "a necessary part of compensation in every case." (See Article 38, Commentary 1). However, in investor-State disputes, it has become usual for parties to request, and for tribunals to include, interest on top of compensation. The awards rendered in 2022-2023 have remained consistent, with all 19 publicly available awards rendered in favor of the investor stipulating interest payments.

The review of the published awards evidenced that the determination of interest remains dependent on the facts of each case. The review discerned, however, certain trends concerning pre-award and post-award interest, the grant of simple or compound interest as well as the award of interest on costs. In addition, tribunals have addressed questions relating to the discontinuance of the LIBOR in cases where the parties did not agree on an alternative rate.

The Discontinuance of LIBOR

The past two years have been characterized by a gradual phase-out of the London Interbank Offered Rate ("LIBOR"), ultimately leading to its permanent discontinuation on 30 June 2023. Currently, over 290 investment treaties in force refer to LIBOR, a benchmark widely accepted by investment tribunals as representative of a reasonable commercial rate.

Following its discontinuance, several tribunals have been compelled to adopt alternative rates employing varied methodologies. Notably, two tribunals refrained from specifying an alternative rate, instead suggesting that if LIBOR ceases to be operational by the payment due date, the parties should adopt "whatever rate is generally considered equivalent to LIBOR in respect of sums due in US dollars" (see *Mol v. Hungary*, para. 708(11); see also *Venezuela US v. Venezuela*).

A different approach was adopted by the tribunal in *DTEK v. Russia*, where the tribunal directed the parties to reach an agreement on an alternative rate, indicating that in the absence of such an agreement, the applicable interest rate would be the Secured Overnight Financing Rate ("SOFR") which is the alternative to LIBOR recommended by the Federal Reserve Board (para. 972).

In two awards that were rendered in cases where the investment treaty referred to LIBOR as the applicable interest rate, tribunals followed different approaches. In *JSC Tashkent v. Kyrgyzstan*, the tribunal declined to supplement the LIBOR while it was still published since the BIT made specific

reference to it. Instead, the tribunal decided that when the LIBOR ceases to exist, "then interest shall accrue at the interest rate 10-year US Treasury rate." (para. 786) Conversely, the tribunal in *Naftogaz v. Russia* recognized the "imminent demise of LIBOR" and opted to fix the interest rate using the Euro Interbank Offered Rate ("EURIBOR") (para. 685).

Finally, in *PACC v. Mexico,* faced with a request for an additional award to determine interests, the tribunal brought to the parties' attention that the LIBOR was being discontinued and invited them to provide observations on possible alternatives. Mexico suggested to apply the SOFR, which the investor contested. The investor contended that, without a premium, SOFR is not a proper alternative to LIBOR. According to the investor, unlike LIBOR which "represents interests on unsecured loans", SOFR is based on "loans backed by U.S. Treasury bonds", is risk free and "does not reflect any credit risk and does not react to market changes in the way that LIBOR does." Considering the divergence, the tribunal decided to apply the LIBOR rate as of May 2023 to any amount outstanding after the discontinuance of LIBOR.

Pre-Award Interest

Pre-award interest compensates the investor for the value of its money over time. When determining the pre-award interest, tribunals examined the potential alternative use of the investor's funds, had the breach never occurred. Absent a specific prescription in the applicable investment treaty or contract, the time value of the money can be compensated by taking into account the use of the money to pay a more expensive debt (cost of debt approach) or taking into account the placement of the sums into an interest-bearing deposit account at a commercial rate (commercial rate approach) (see e.g. *Rand v. Serbia*, para. 706).

The commercial rate approach remains the dominant approach with ISDS tribunals applying the LIBOR, EURIBOR and even SOFR (see *Gardabani v. Georgia*). The application of a commercial interest rate should not, however, serve a punitive purpose, since international law does not recognize punitive interest (see *Venezuela US v. Venezuela*). This question arose in *JSC Tashkent v. Kyrgyzstan*. Operating under a treaty that referred to LIBOR for a lawful expropriation, the majority of the tribunal applied, to an unlawful expropriation, LIBOR + 4% deeming such rate reasonable as it constituted "LIBOR plus an appropriate margin." Prof. Douglas considered in his dissenting opinion that the addition of the 4% margin "represent[ed] an additional punitive element on top of the compensation that would make the Claimants whole." (para. 116)

The time value of money can also be compensated by applying the State's costs of debt under the "forced loan" theory according to which the damage is to be considered as a forced loan from the investor to the State. The rationale is that between the date of the breach and the date of the award, the investor is only exposed to the risk of not obtaining damages due to the State's default (see *IC Power v. Peru*). The State's sovereign cost of debt approach has been followed in 31% of the awards rendered in 2022-2023 (e.g. *Michael Antony v. Dominican republic* and *Banco Bilbao v. Bolivia*). Moreover, in the same period, it was applied in 75% of the Spanish renewable energy cases, albeit with different maturity dates which differed on the basis of the valuation date (see *Eurus v. Spain, Infracapital v. Spain* and *RENERGY v. Spain*).

Post-Award Interest

Post-award interest has been granted in all instances, save for one, using the same rate utilized for pre-award interest. Tribunals justified granting the same rate for pre-award and post-award interest by referring to the prohibition against awarding punitive interest. The *RENERGY* tribunal recalled in that respect that interest is meant to uphold the principle of full reparation, not to "punish the responsible State." Similarly, in *Sevilla v. Spain*, the tribunal did not deem it necessary to distinguish between pre-award and post-award interest rates since "the duty to pay interest does not pursue any punitive objective."

In *Infracapital v. Spain*, Spain objected to the application of a higher post-award interest rate characterizing it as punitive. The investor, on the other hand, suggested that a higher interest rate would be punitive only if Spain delayed the payment. The tribunal granted the investor's request and granted a higher post-award interest rate considering that:

> "awarding post-award interest serves the purpose of incentivising compliance with the terms of the Award as expediently as possible."

Authors have indeed considered that the function of post-award interest is to "ensure prompt compliance" with the award and that consequently "the rate of post-award interest shall not be lower than the rate of the government bonds in the host State." (see I. Uchkunova, O. Temnikov, A Procrustean Bed: Pre- and Post-award Interest in ICSID Arbitrations, ICSID Review, 2014, Vol. 29, Issue 3) Others, however, have doubted whether post-award interest can "punish the respondent for non-compliance with the award."

Simple vs. Compound Interest

The difference between simple and compound interest is straightforward: simple interest is calculated on the basis of the principal while compound interest is calculated on the basis of the principal and the interest of the previous period.

Continuing the trend from previous years, 16 tribunals awarded compound interest, on a monthly (two cases), semiannual (four cases) or annual (10 cases) basis, considering that "compound interest is now the rule in international investment arbitration." (see *Gramercy v. Peru*, para. 1325) Tribunals considered that compounding interest corresponds to the economic reality since "even if the funds had simply been deposited in a bank account generating interest, that interest would have been compounded." (see *Venezuela US v. Venezuela*, para. 92).

Only two tribunals granted simple interest. In *Gardabani v. Georgia*, the investor initiated a contract-based SCC arbitration and a treaty-based ICSID arbitration. Both cases were heard by an equally composed tribunal. In the SCC arbitration, the tribunal granted simple interest referencing the prohibition of compound interest under Georgian law. In the ICSID arbitration, the tribunal recognized that compound interest is often awarded, but was not persuaded that it was appropriate in that instance since it saw no basis for awarding different interest rates in the two arbitrations.

In *Mol v. Croatia*, the tribunal declined to grant compound interest finding that the investor did not justify what difference compound interest would make in the specific circumstances of the case. The tribunal noted that while there is a "tendency towards the award of compound interest", the

"practice of investment tribunals remains divided." (para. 694) For the tribunal, the award of compound interest must be justified as necessary to achieve full reparation, the burden of proof lying on the party claiming it.

Interest Rate on Allocation of Costs

Tribunals have systematically granted interest on the costs of the parties when such requests were made (e.g. *Mercuria v. Poland* and *Venezuela Holding v. Venezuela*). Tribunals generally awarded the same interest rate as the one awarded for the damage, although some tribunals opted to award a different interest rate (see *Venezuela US v. Venezuela*) or opted for the higher post-award rate (see *Infracapital v. Spain*). In cases where no damages were awarded to the investor, but costs were granted to the State, tribunals applied the SOFR (see *Peteris v. Norway* and *Mihaljevic v. Croatia*).

Conclusion

In summary, in 2022-2023, tribunals continued to systematically include the payment of interest when allocating compensation. While the discontinuance of the LIBOR posed challenges, tribunals adopted various solutions, applying for instance alternative rates such as SOFR or EURIBOR. Awarding compound interest remained the predominant practice of tribunals, which usually also applied the same rate for pre-award and post-award interest.

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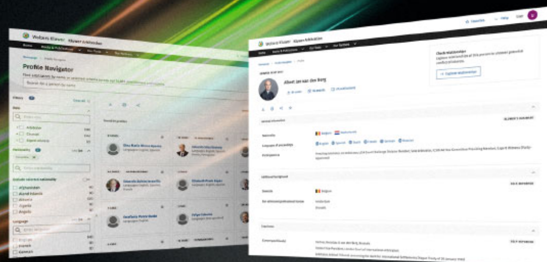

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