FIRST DISCUSSIONS ON DAMAGES IN THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM AT UNCITRAL WORKING GROUP III

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This paper summarises the history of initial discussions within UNCITRAL Working Group III (WG.III) on the reform of investor-state dispute settlement (ISDS) regarding the lack of correctness, consistency and predictability of compensation awards. It covers the period up to 2022, beginning with the initial concerns expressed by some countries of the Global South regarding the methodologies used to assess damages and the Draft on Damage Assessment and Compensation prepared by the UNCITRAL Secretariat, which served as the basis for subsequent discussions among the members of WG.III. It then describes the comments made by some states and observers on this draft and the discussions that ensued, including the discussion of damages as part of the issues of ISDS reform. A second paper on this topic will describe the period from September 2022 to the publication by the Secretariat of the second draft of procedural and cross-cutting issues on July 8, 2024.

The purpose of this paper is to provide Global South States with a track record of the main concerns expressed by States on various aspects of damages during the discussions in UNCITRAL WG.III, which have often been lost at some point during the long process of discussions on ISDS reform.

Abstract

There is a general understanding among States and scholars of the lack of correctness, predictability, and consistency of decisions on compensation ordered against States by ISDS tribunals. This discussion has been brought to the attention of UNCITRAL's Working Group III, in particular regarding the way in which tribunals assess damages and their compensation, where States have expressed varying degrees of concern, different views on how to address these issues, the timing of the discussions or the degree of importance of the various topics, among others.

In light of the above, WG III members discussed, among other things, the trend toward exaggerated monetary awards, the significant disparity between the valuations of plaintiffs' and defendants' experts, the increase in award amounts, methods of calculating damages,

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causation, burden of proof, standard of proof, methods of calculating interest, and factors limiting the amount of an award, among others.

On these issues of interest to WG III, the Secretariat was mandated to research and prepare a document (A/CN.9/WG.III/WP.220), which was circulated to WG III members for comment. Subsequently, the Secretariat prepared draft provisions on procedural and cross-cutting issues (A/CN.9/WG.III/WP.231), which were also circulated for comment and to which reference is made elsewhere.[2]

I. Introduction

The rules and principles on the determination of damages and the assessment, valuation, and determination of the loss suffered are vital for the parties to the ISDS system. The loss as a result of the violation of the protection provided in the bilateral investment treaty (BIT) moves the investor to submit the claim against the State for compensation. The loss suffered becomes the motive, the driving force behind the resolution of the dispute between the parties. Therefore, a flawed evaluation, assessment and determination of losses by the arbitral tribunals undermines the legitimacy of the system, since it ends up seriously affecting one of the parties. To the investor, when the value of the damage in the award does not fully compensate for the loss suffered, which may affect the development of new projects, etc. And to the State, because if the arbitral tribunal overestimates the value of the damage, it will face an overcompensation that will affect the finances of the State, including halting social programs to pay the award.[3] Consequently, the assessment of the alleged losses reflected in the claims in disputes between the investor and the state, and the manner in which that harm is assessed, is crucial to both parties in the ISDS system, where the amounts at stake can typically reach sums far above any loss or damage incurred .[4]

The sums involved in investor-state disputes are high and rising, as are the awards,[5] according to public data from the United Nations Conference on Trade and Development ("UNCTAD") and other academic work,[6] which indicate that the average value of awards issued between 2010 and 2019 is 15,718.42 times higher than decisions issued between 1990 and 1999 (or 6,476.31 excluding *Yukos* awards against the Russian Federation).[7]

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[2] See, *Discussions on Draft Provisions on Damages in the Investor-State Dispute Settlement System in UNCITRAL Working Group III*, Research Paper 207, 29 August 2024, South Centre.

[3] UNCITRAL. Secretariat Report on Session 46. A/CN.9/1160, par. 99-100. 99-100

[4] In this paper, we follow the International Law Commission's ("ILC Articles") and the WG III Secretariat's Note on "Assessment of Damages and Compensation" in the possible reform of ISDS, understanding "damage", "harm" and “injury” as the loss suffered by the victim of a wrongful act and "compensation" as the generic form of the amount payable to a party for such loss.

[5] For example, in ICSID Case No. ARB/07/30 (*ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*) the value of the claims exceeded US$30 billion and the final award exceeded US$8.7 billion. In ICSID Case No. ARB/12/1 (*Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*), the value of the claims exceeded US$8.5 billion and the final award exceeded US$4.087 billion.

[6] UNCTAD. *Investment Dispute Settlement Navigator*. UNCTAD Investment Policy Hub. Updated as of December 31, 2023. https://investmentpolicy.unctad.org/investment-dispute-settlement.

[7] Bonnitcha, Jonathan, Malcolm Langford, Jose M. Alvarez-Zarate and Daniel Behn. "Damages and ISDS Reform: Between Procedure and Substance." Journal of International Dispute Settlement, December 2, 2021.

Discussions in UNCITRAL Working Group III (WG.III) have finally opened the possibility of including the issue of damages and compensation in possible reforms of the Investor-State Dispute Settlement (ISDS) system. This was done at the request of several States since the 38th Session on October 14-18, 2019.[8] This issue was included among other additional questions on options for ISDS reform, for which it was proposed that the Secretariat be tasked with research on "damages, the methodologies for calculating such damages, and the principles underlying them".[9]

As a result, some of the concerns of countries of the global South regarding the way in which damages and compensation are assessed were included in WG.III discussions. This resulted from arduous discussions, although it was emphasised that the list of reform options contained in document A/CN.9/WG.III/WP.166 was a non-exhaustive summary without any order or priority, and that the list could be revised at a later stage of deliberations. Finally, it was considered that the Secretariat could undertake research on damages, the methods of calculating them and their principles. WG III considered that it would be useful to carefully examine the stage at which the Tribunal calculates damages, the evidential requirements, untested accounting and financial standards and the relationship with cost allocation.[10]

According to public information, as of August 2019, there have been 44 awards of $100 million or more, and nine awards amounting to $1 billion or more. From the first decision 1981, it took 21 years for the cumulative number of awards to reach $10 billion. By 2006, the cumulative amount had doubled to $20 billion and four years later, in 2010, it had doubled again to $40 billion.[11] In addition, the compensation awarded often far exceeds the costs incurred by investors in the investment, and the calculation of compensation does not consider the benefits of the investment to the host state or whether the investor has engaged in misconduct, such as human rights violations.[12]

A Latin-American and Spaniard sample of ten countries with 174[13] cases reveal that between 1996 and 2023, arbitration tribunals condemned the State in 104 cases reaching a59.77%,

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https://doi.org/10.1093/jnlids/idab034. P. 6-7. For more detail see the work of Daniel Behn, Malcolm Langford, Ole Kristian Fauchald, Runar Lie, Maxim Usynin, Taylor St John, Laura Letourneau-Tremblay, Tarald Berge & Tori Loven Kirkebø, *PITAD Investment Law and Arbitration Database: Version 1.0*. Pluricourts Centre of Excellence, University of Oslo (31 January 2019).

[8] Interest on the subject had previously been expressed in February 2018. UNCITRAL. A/CN.9/930/Add.1/Rev.1. par. 30; and April 2019. UNCITRAL. A/CN.9/970. paras. 36-38.

[9] See Report from October 23, 2019. UNCITRAL. A/CN.9/1004. para. 24 & 102.

[10] See UNCITRAL. A/CN.9/1004. paras. 17, 23, 24, 102 & 104.

[11] Footnote 68 states that "The Hart and Velez study, p. 13, concludes that the amount of damages claimed in recent years seems to have stabilized, albeit at a high level. The Academic Forum document mentions different data and studies, all of which show a considerable increase in the last decades. For example, according to data from UNCTAD and ITALAW, the median value of awards granted was US$2 million between 1990 and 1999; US$16.7 million between 2000 and 2009; and US$32.9 million between 2010 and 2019; see section 2.2. According to the PluriCourts Investment Arbitration Database (PITAD), the median value of awards was US$4.2 million between 1980 and 1999; US$21.3 million between 2000 and 2009; and US$27.8 million between 2010 and 2019; see section 2.3. The median figure is not the average of all awards made, but a mean value that is not influenced by awards made for very low or extremely high amounts.

[12] See A/CN/WG.III/WP220. par. 68.

[13] Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Spain and Venezuela.

ordering compensation to investors for an approximate value of 24,661,060,000 USD. In the remaining 40.22%, 70 cases, the State obtained favourable decisions.[14] The remaining 70 cases were discontinued.[15]

Of the 352 claims filed since 1996, 104 were pending as of May 2024, and we do not have information regarding the value of the claims in 59 of these cases. However, we note that in 45 of the pending disputes, the value of the claims is publicly available and would exceed approximately $32,352,800,000. In other words, in 43.27% of the known cases the parties are disputing over USD 32,352,800,000,000 in damages. Extrapolating this sum to the 56.73% of cases we are not aware of, it is possible that the total value of claims at issue in these 104 cases could exceed US$80 billion.[16]

II. Issues raised during discussions

There is a common understanding among WG.III that the complexity of damage assessment presents challenges with respect to the correctness, consistency and predictability of compensation awards.[17] A significant portion of WG.III participants believe that the inconsistency and lack of predictability of damages awards is one of the most frequently encountered problems in the ISDS system. They also note that the trend of exaggerated claims, the gap between the valuations of claimants' and defendants' experts is of concern, which increases in natural resource cases requiring complex valuations. The failure of arbitrators to mitigate this risk leads to monumental economic mistakes, for which states usually pay the price. It is therefore important to have a system of checks and balances to limit the risk of abuse.[18]

In WG.III, Indonesia stated that in order to address this concern, a guideline that includes checks and balances for claims should be developed, a method for valuing a business in accordance with accepted international accounting standards, a code of conduct for arbitrators to assess valuation and a mechanism for dismissing frivolous claims at an early stage.[19] For its part, Colombia expressed concern on the valuation methods, where it has proposed that the issue be included in the ISDS reform discussion.[20]

In addition to the above, South Africa has expressed that the high damages of investment arbitration lead to regulatory chill, so ISDS should provide for exclusions.[21] In addition, even if unsuccessful, the claims cause reputational damage to the country.[22] In addition, South Africa expressed concerns that the Multilateral Investment Court has the potential to prevent

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[14] The difference between acquittals and convictions is significant, representing 19.54% of the cases.
[15] In the methodology used here, discontinued and settled cases are discounted because they do not have a final decision by the arbitrators. UNCTAD. *Investment Dispute Settlement Navigator*. UNCTAD Investment Policy Hub. Updated as of December 31, 2023. https://investmentpolicy.unctad.org/investment-dispute-settlement.
[16] Own calculations based on UNCTAD Investment Policy Hub, https://investmentpolicy.unctad.org/investment-dispute-settlement
[17] UNCITRAL. A/CN.9/1124, par. 91 of October 7, 2022. Report of the Session of September 5-16, 2022.
[18] UNCITRAL. A/CN.9/WG.III/WP.156 par. 8. Submission of Indonesia, 9 November 2018.
[19] Ibid. par. 9
[20] UNCITRAL. A/CN.9/WG.III/WP.173. June 2019. p. 8.
[21] UNCITRAL. A/CN.9/WG.III/WP.176. par. 63.
[22] Ibid. par. 67

States from taking action to address climate change, in contrast to domestic courts, where the Multilateral Investment Court will allow investors to claim compensation. This situation will lead to prohibitively costly reforms, causing regulatory chill, undermining the country's regulatory ability and consequently preventing it from taking crucial measures in times of crisis, including climate change.[23] To address some of these problems, South Africa proposed the development of an instrument to guide the valuation of damages, as this can reduce the inconsistency and unpredictability of awards.[24]

Chile, Israel, Japan, Mexico, and Peru jointly presented their proposal on the approach to ISDS reform, identifying some of the cases and rules adopted in their proposals.[25] These countries propose limiting claims on indirect losses, stating that International Investment Agreements (IIAs) could limit claims that can be brought by "shareholders to direct losses only or for indirect losses to subsidiaries that they own or control have been successfully limited opportunities for multiple inconsistent decisions and unnecessary and duplicative proceedings".[26] This has contributed to the issuance of correct decisions with respect to the recognition of damages. For example, they cite the case of *Bilcon of Delaware et al v. Government of Canada*, where the award of damages was limited to direct losses suffered, excluding indirect losses caused to the subsidiary.

Burkina Faso identified several concerns regarding the determination of compensation (assessment and award of damages) in the current ISDS system.[27] Among other things, it highlighted the impact of the economic costs on developing countries, not only because of the value of the procedures but also because of the high amounts of compensation, and therefore considered that "it is essential that Working Group III undertakes to identify the best options to reduce the cost of compensation", and highlights the importance of a "comprehensive harmonisation of the rules governing compensation". It also noted that the current system does not take into account the large differences between the amounts invested and the amounts awarded as compensation[28] creating a complex and inconsistent system due to the discretionary nature of the evaluation criteria in each case. This has also contributed to the increase in compensation. It also highlighted the tribunals' lack of consideration of contextual factors such as the public interest, the conduct of the investor, and the ability of the host state to pay and it links the lack of uniform evaluation criteria to a possible regulatory freeze.[29]

In this regard, Burkina Faso stressed the importance of reconsidering the rules and modalities for calculating damages under the ISDS system, for which it proposed rules that explicitly

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[23] Ibid. para. 101-102.
[24] Ibid. par. 73.
[25] UNCITRAL. A/CN.9/WG.III/WP.182. Circulated on October the 2nd, 2019. p. 2. See also A/CN.9/WG.III/WP.170 on reflected losses.
[26] UNCITRAL. A/CN.9/WG.III/WP.182, p. 3.
[27] UNCITRAL. A/CN.9/WG.III/WP.199. Communication from the Government of Burkina Faso of 9 November, 2020.
[28] Burkina Faso understands that these differences arise from the rules governing compensation, which require a tribunal to award compensation on the basis of the financial position that the investor would have had if the State had not breached the treaty.
[29] Ibid. para. 3, 5, 6, 7 & 10.

clarify the methods used to calculate damages, in order to reduce the risk that the Tribunal's interpretation will be contrary to the intentions of the parties to the treaty. It also proposed establishing rules for compensation in cases of expropriation and other breaches of the treaty and the adoption of clear rules on lost profits; the possibility of limiting compensation to the amount invested in certain cases where the project was not implemented; the elaboration of clear rules on moral or punitive damages; and the provision of a second instance with a wide margin of configuration.[30] Burkina Faso believes that all these proposals should aim to be no more generous, in general, than those provided for by national laws.[31]

For Morocco, a reform of ISDS should lead to responsible international investments that promote sustainable development goals and combat the practice of suing in arbitration tribunals to obtain undeserved compensation, with developing countries suffering the negative financial consequences. Therefore, in order to reduce the costs of arbitration and the impact on public policy, it suggests that consideration be given to the adoption of objective and transparent criteria for determining the amount of damages awarded to investors, as it is important that the amount of damages awarded be "proportionate", measured in relation to the actual harm suffered.[32]

III. The draft on damage assessment and compensation[33]

A. The content of the draft

As a result of the mandate of WG.III, the Secretariat prepared a draft on "Assessment of Damages and Compensation", which it circulated as a preliminary note on the subject, open for comments until 30 November 2021.[34] In general, the draft summarizes some key issues in the assessment of damages and the determination of compensation under investment treaties (see paragraph 8). It begins by describing the rules and techniques for assessing damage and determining compensation. It goes on to describe the existing tools, adopting the distinction between lawful and unlawful expropriation, breaches of other IIA obligations, and the limitation on compensation for damages. It also shows key issues, such as valuation methods, causation, the burden of proof and standard of proof, different ways of calculating interest, tribunal decisions on the subject, the role of experts, and other factors limiting the value of compensation. Finally, it suggests some issues for consideration and possible work to address them, such as the complexity and lack of certainty of current practice, high compensation amounts, the increasing value of claims, ways to deal with the discrepancy between claimed loss and recognised damages, including excessive claims, as well as differences in expert calculations of damages.

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[30] Ibid. par. 11.
[31] Ibid. par. 12.
[32] UNCITRAL. A/CN.9/WG.III/WP.161. para. 4-5 & 14. Submission of Morocco
[33] On July 5, 2022, the Secretariat circulated Note UNCITRAL. A/CN.9/WG.III/WP.220, which generally endorsed the initial draft on damages.
[34] This document received comments from Canada on November 21, 2021, Colombia on November 15, 2021, Panama on November 16, 2021, Switzerland on November 30, 2021, the United States on November 15, 2021, the International Law Institute on November 9, 2021, the CCSI, IISD, IIED on November 12, 2021.

The draft shows IIAs that include elements for determining fair market value in expropriations, such as the Indonesia-Switzerland BIT (2022), and the EU-Singapore Investment Protection Agreement, with respect to factors such as going concern value, asset value, declared tax value of tangible property, and other criteria. It also shows some examples of fair and adequate compensation and contextual factors.[35] It also describes challenges to the application of the fair value method when (i) the investor has not been permanently and totally deprived of the investment and its value; (ii) the investor continues to operate the investment, and (iii) the ability to use or control the investment has not been significantly impaired.[36]

Finally, it shows several recent IIAs that included some conditions limiting the compensation so that it is not greater than the loss suffered, and any previous loss is subtracted.[37] Also required the verification of a *sufficiently close* causal link between the violation and the damage[38] and provided for mitigating factors in the calculation of compensation.[39] (see par. 19).

B. Key issues

Finally, the draft highlights several issues for possible discussion: i) the method of valuation; ii) causation; iii) the burden and standard of proof; iv) the calculation and determination of interest; v) the role of experts; and vi) other factors limiting the amount of compensation.

Method of valuation. The draft notes that neither customary international law nor investment treaties require the use of a particular method of valuation, and that tribunals have discretion to choose among the methods presented by the parties.[40] On this basis, it

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[35] Par. 13, Citation No. 14, of the Note, where compensation must reflect "an equitable balance between the public interest and the interest of those affected, taking into account all relevant circumstances and taking into consideration the current and past use of the property, the history of the acquisition, the fair market value of the property, the purpose of the expropriation, the extent of past benefits obtained by the foreign investor through the investment, and the duration of the investment" Also reference SADC Model Bilateral Investment Treaty (2012), Article 6.2; see also Common Market of the South, Article 6(2)(2)(2); see also Common Market for Eastern and Southern Africa Common Investment Area Agreement (COMESA) and Pan-African Investment Code (PAIC)). C.F. citation 13 of the Note.

[36] UNCITRAL. A/CN.9/WG.III/WP.220 (para. 18)

[37] See footnote No. 21, Netherlands Model BIT (2019), Article 22 (3); EU-Singapore Investment Protection Agreement (2018), Article 3.18; EU-Viet Nam Investment Protection Agreement (2019), Article 3.53; CETA, Article 8.12 (3) and 8.39(3); India Model BIT (2015), Article 26.3; India-Kyrgyzstan BIT (2019), Article 23(3); India-Belarus BIT (2018), Article 26.3; Canada Model Foreign Investment Promotion and Protection Agreement (Canada 2021 Model FIPA), Article 40 (5).

[38] See footnote No. 22, TPP, Article 9.29 (4): "(...) the only damages that may be awarded are those that the claimant has proven were sustained in the attempt to make the investment, provided that the claimant also proves that the breach was the proximate cause of those damages. (...)"; Canada 2021 Model FIPA, Article 40 (5).

[39] See footnote No. 23, Indian Model BIT (2015), Article 26.3; India-Belarus BIT (2018), Article 26.3.

[40] On the authority of arbitrators, this was developed by arbitral tribunals to expand their power and discretion to decide on the value of the award, to evaluate the evidence that proves the damage, its extent and value of losses, or on the contrary, that it was not caused, was not representative or that its value is not the one claimed. *Nineteenth Century Arbitrators' Powers—Has There Been Any Progress to Date?* osé Manuel Álvarez Zárate. "Nineteenth Century Arbitrators' Powers—Has There Been Any Progress to Date?". Law & Practice of

describes tribunal's most commonly used retrospective and prospective methodologies[41] and recognises that different valuation methods may lead to different results.[42]

The draft addresses the choice of valuation method and what the tribunals are supposed to take into account. It comments on the "appropriate application of the DCF method", and questions its use for non-operating assets, businesses with limited operating history and market information when the investment is unique. Additionally, it draws attention to the significant disagreements regarding the different assumptions, projections, discount rates, and risk, as well as the difficulty of correctly estimating all values, where the risk of speculation increases when factors are projected over time. In this regard, he recalls the caution of the commentaries to the ILC Articles and the World Bank Guidelines on the application of the DCF, but that despite this, the DCF is increasingly being used by arbitral tribunals, which has contributed to the increase in awards. (par. 29-32).

Finally, it notes that the choice of valuation date also significantly impacts the value of compensation and distinguishes between the date for legal, illegal expropriations and other violations.

Causality. IIAs generally do not include standards or tests for proving causation. Only a few include some language that the losses must occur "by reason of" or "arising out of the state measure". At the same time, it recalls that Article 31 of the ILC Articles states that the injury needs to be "caused by" an illegal international act, that "the causal connection between the breach of an agreement and the loss claimed must not be too speculative, remote or uncertain." Further, that there are other "terms used to describe the link that must exist between the wrongful act and the injury in order for the obligation of reparation to arise. The terms generally used are remoteness, directness, proximity and foreseeability." [43]

Burden of proof and standard of proof required. The party alleging a fact has the burden of proof. The investor must prove the damage, the amount of the damage and the causality.[44] For its part, the State must prove the circumstances limiting causation or the amount of the loss. In the absence of regulation on the evidentiary criteria, the arbitration

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International Courts and Tribunals 17, n.º 1 (june 27th, 2018). P.. 15. https://doi.org/10.1163/15718034-12341377.

[41] See, par. 22-26. Retrospectives are asset-based, using the book value or replacement value of the asset. The historical approach takes the amount invested up to before the breach. Prospective approaches model expected returns to predict how it would behave and develop in the future but for the illegal act of the State. This methodology assumes the value of a business based on its ability to generate profits. The market-based approach and the income-based approach are the most common. The former compares the business with the value of similar businesses in the market, while the latter converts anticipated economic benefits to present value using the Discounted Cash Flow (DCF) method.

[42] See, par 20 of the Draft, *Tethyan Copper Company PTY Limited v Islamic Republic of Pakistan* (ICSID ARB/12/1, award of July 12, 2019, and *Bear Creek Mining Corporation v Republic of Peru*, (ICSID ARB 14/21, award of November 30, 2019).

[43] See, para. 34-35.

[44] Article 36.2 of the ILC Articles states that compensation shall cover damages that are economically assessable and proven; as for loss of profit, this must be certain.

rules are taken as a source, which grant certain discretion to determine the admission, relevance, materiality, weight and probative value at the time of evaluating the evidence.[45] (par. 36-38)

Award of interest and how it is calculated. The draft states that interest is part of the full reparation because it compensates for the loss of the use of money. But the principle of full reparation does not define the necessary elements to calculate the interest rate, nor whether the interest should be simple or compound, which influences the insecurity and lack of predictability of the amount of interest to be paid. This, together with the length of the proceedings, represents a significant portion of the total compensation, which is of obvious economic importance (par. 39-41).

The Draft shows the different options available to tribunals to apply the pre-award interest rate: on bank deposits, the "risk-free" rate, the regulatory framework's rate of return on investment, or the average cost of capital. But despite the options, they usually charge the interbank rate plus a premium "to reflect the market value of money in a given currency". For post-award interest, he mentions that rates are possibly higher and that these are determined by three factors: "(i) preservation of the normal market value of the compensation awarded in the award; (ii) compensation for the risks inherent in collecting the amount awarded, including the risk of non-payment; and (iii) the desire to discourage late payment and the use of the arbitration award as a source of cheap financing." Some tribunals apply a higher interest rate to discourage delay in payment, even apply compound interest (par. 44-46).

Simple or compound interest. The decision to apply simple or compound interest and the compounding intervals affects the value of the award. Currently, tribunals are awarding compound interest more frequently. Prior to 2005 in 50% of cases, but between 2011 and 2015 that proportion rose to 87%, which has resulted in high interest awards, in some cases exceeding the principal sum. This trend may be contrary to what is expressed in Article 38 (paras. 8 to 12), of the ILC Articles, which state that unless there are compelling reasons to award compound interest, it is more appropriate to apply simple interest. The intervals of capitalisation are variable, six months or one year, for example (par. 47-50).

Other factors limiting the amount to be indemnified. The investor's concurrent fault and failure to mitigate losses may be considered when calculating the compensation amount. The first circumstance is found in article 39 of the ILC Articles, while the second is found in the commentary to article 31.

C. Matters that could be examined and possible work

The Secretariat draft suggests raising the desirability of (i) formulating provisions, possibly binding, on procedural issues related to the assessment of damages to be included in IIAs, arbitration rules or a multilateral instrument to be included in the

[45] This discretion of the arbitral tribunals must follow principles of reasonableness, justification, motivation and coherence, at least.

procedural reform; and (ii) developing guidelines and standards on this issue to be provided to ISDS tribunals.

Complexity and lack of certainty. The lack of regulation of the parameters for calculating damages contributes to increased costs and has a negative impact on the correctness, consistency and predictability of the calculation of compensation. For discussion, the draft proposes to work on proposals for treaty provisions or guidelines on the following topics: (i) compensation for unlawful expropriation and non-expropriatory breaches; (ii) the method of valuation (with an indication of whether the DCF method is appropriate and a reference to the use of sensitivity analysis or alternative assumptions, among other things); (iii) the date of valuation; (iv) the claimant's conduct that would limit the amount of compensation; (v) the causal link between the breach and the loss; (vi) evidentiary requirements, including the standard of proof required; (vii) pre- and post-award interest (the interest rate, the method of calculation and the possibility of capitalization of interest); (viii) the admissibility of requests to increase the award to cover taxes allegedly payable by the claimant on the respective amount; (ix) the possible role of national agencies and domestic law in the calculation of damages; (x) the role of experts in the determination of damages, including the means of appointment and the ethical regime applicable to them; and, (xi) the allocation of costs taking into account various factors, such as the outcome of the proceedings, the conduct of the parties, reasonableness. (par. 64, 65)

High amounts of compensation and increase in the amounts claimed. Given the high level of claims and the increase in the amount of compensation awarded against States by the Tribunals, the draft proposes to examine this issue. Along with this, awards that exceed the expenses incurred by investors, where the benefit to the State and the investor's misconduct are not taken into account when calculating compensation. The review could address "(i) the use of valuation methods, including the appropriate discount rate to apply to calculations made under the DCF method and to the calculation of interest; (ii) the setting of a cap on compensation, for example, in excess of the amount invested by the investor; and (iii) contextual factors, such as the ability of the host State to pay the compensation awarded, the potential 'chilling effect' of an award on the respondent State, and the benefits of the investment for the achievement of the State's sustainable development objectives." (par. 66-69)

Ways to resolve discrepancies between claimed losses and awarded damages, including excessive claims**.** Several studies show that, on average, claims exceed the damages awarded by up to three times. Excluding three outlier cases, claims can reach up to five times the average awarded. The problem with this situation is that excessive claims can create an "anchoring effect" and cognitive bias in arbitral tribunals. Therefore, awarding costs to the claimant could be considered to discourage exaggeration of the amount of damages claimed if they exceed the actual loss determined by the tribunal. (par. 70-73)

Differences in damages calculated by different experts. One study found these divergences are "partly due to experts receiving instructions from lawyers and answering different questions that were possibly based on different factual or legal assumptions." The draft notes that this circumstance could be considered in drafting provisions for

inclusion in treaties or in the formulation of guidelines,[46] where the appointment of experts may assist the tribunal in calculating damages. This would promote greater impartiality and independence of the experts and reduce the overall cost of the proceedings.

Guidelines could also be developed for party experts to: (i) ensure that their outcomes are developed "according to a harmonised and clearly defined set of instructions based on similar assumptions; (ii) require further calculations to be submitted in case of disagreement on facts and legal approaches; (iii) require experts to issue a joint statement explaining differences where the conclusions of the expert opinions differ; and, (iv) urge party-appointed experts to work as a team to issue a joint opinion, and empower tribunals to direct the experts." (par. 74-77)

Relationship with other reform options. The issue of injury and its compensation is linked to other reform options that would have to be assessed as a whole, such as: "(i) early dismissal of speculative, unfounded and exaggerated claims (A/CN.9/WG.III/WP.219); (ii) third-party funding to avoid claims for high amounts of compensation (A/CN.9/WG.III/WP.219); (iii) the creation of appeal mechanisms and a permanent multilateral mechanism to ensure that procedurally and substantively correct decisions are rendered and rectified (A/CN.9/WG.III/WP.218); (iii) the establishment of appellate mechanisms and a permanent multilateral mechanism to ensure that procedurally and substantively correct decisions are rendered and that errors that may have been made in the decisions of ISDS tribunals are rectified (A/CN.9/(iv) ways to address policy paralysis; and (v) ways to address the issue of multiple proceedings, in particular those involving shareholder claims and reflex losses (A/CN.9/WG.III/WP.170 and A/CN.9/WG.III/WP.193)" (par. 78).

D. Comments from States

Several countries and organizations commented on the draft contained in the Secretariat Note.[47] Some seek to limit the discussion by pointing out that any reform options should be consistent with the mandate to consider procedural reforms.[48]

The United States suggests separating the elements of damages and compensation valuation related to the dispute resolution process from those related to the substantive legal principles guiding valuation. According to this delegation, this would help to assess the extent and type of reform that might be appropriate, desirable and achievable. In their view, what is not part of the general experience of WG III should be avoided, such as developing broad applicable guidelines or causation-related provisions as a principle for damage valuation and compensation that may derive from general principles or types of damages available from the law of state liability.

[46] Footnote 78 notes that some existing instruments, such as the Protocol on Determination of Damages in Arbitration of the International Committee on Arbitration of the International Institute for Conflict Prevention & Resolution (CPR), could be useful.
[47] Canada, Colombia, Panama, Switzerland, the United States, the Institute of International Law, and the joint comments of CCSI, IISD, IIED.
[48] United States, Canada and Switzerland.

In addition to sorting out procedural and substantive issues, the United States suggests distinguishing between technical procedural reforms and those involving policy choices to be addressed in separate documents. On the technical side, best practices could be identified to focus on the process of assessing damages, such as specifying rules of evidence, or the competence and ethical considerations for choosing experts. On the other hand, provisions recommending a particular method of valuation or imposing ex ante limits on damages would be part of the substantive law of damages and compensation, which should not be dealt with, nor should rules of evidence, causation, mitigation and other legal rules. In terms of policy issues, only those related to the dispute settlement process should be addressed, such as the allocation of costs when damage calculations are unreasonable because they are inflated as an "anchor" of the award by litigation strategy.[49]

Canada stated that the various issues related to damages and compensation deserved attention and further discussion to determine how best to address these issues, either within the current WG.III work plan or as a separate issue. It commented on assessment methodology, causation, evidentiary requirements, interest, the role of experts, factors limiting the amount of compensation, issues for consideration and possible work.[50]

Canada notes that the assessment of damages and compensation intersects with several issues that cannot be addressed from a procedural perspective alone due to the substantive nature of the issues involved. Thus, "[t]he development of commentary or guidelines for arbitral tribunals on the legal framework for assessing damages and compensation, and for the application of valuation methods might be the best option to ensure better and more predictable awards."[51]

Regarding the assessment methodology for the calculation of damages, Canada states that several principles should guide tribunals: (i) they shall not be greater than the loss or damage suffered by the investor on the date of the breach; (ii) they shall only reflect the loss or damage suffered because of or arising out of the breach; and (iii) they shall be determined with reasonable certainty,[52] not be speculative or hypothetical. Loss of profits should only be awarded to the extent that the damages satisfy the exact requirements. It also agrees with the Secretariat's Draft that the award for lost profits may be disproportionate and inflated concerning the loss suffered. This problem arises, in part, from the fact that some investment tribunals simply assume without careful analysis that lost profits are compensable, coupled with the reliance of these tribunals on the DCF methodology in cases where the calculation depends on multiple variables and uncertain inputs that lead to an inflated award.[53]

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[49] United States of America. *USA Comments on Draft Note on Assessment of Damages and Compensation*. November 15, 2021.
[50] Canada. *Submission by the Government of Canada, Possible Reform of Investor-State Dispute Settlement (ISDS): Assessment of Damages And Compensation*. November 2021
[51] Ibid. P. 4.
[52] Reasonable Certainty would be different from the sufficiency of certainty provided for in the commentaries to Article 36, paragraph 27 of the ILC Articles.
[53] Canada. P. 1-2

In addition, Canada is concerned about the need for more attention of some tribunals to legal and factual causation in damage awards. , Therefore, Canada suggests working texts to reinforce the causation link, which is necessary between the specific breach and any damages award, and to further explore the possibility of guiding tribunals on causation with respect to contributory fault.

Regarding the evidentiary requirements, it mentions that the burden of proving causation, the fact of the loss and the value of the loss is on the plaintiff, while it is incumbent on the defendant to prove mitigation or concurrent fault. Thus, the quantification of the damage should not be subject to a lower rule, and the amount should be established with reasonable certainty. This leads to the point that, in the choice of methodology and approach to quantification, tribunals should base their assessment based on what is presented by the parties and, if necessary, may ask the parties to clarify specific issues, e.g., factors and calculations.

On interest, Canada comments that tribunals should have some discretion to award interest before and after the award, provided that it is ensured that this does not result in overcompensation, the interest is reasonable and that the investor proves the facts justifying the award of interest, including compound interest according to the circumstances of the case. A set of guidelines on determining the appropriate interest rate, whether and when it should be applied before or after the award, and whether it should be compound or simple could achieve greater predictability in the award of interest. [54]

Concerning the role of experts, Canada finds it difficult to replace the appointment of experts by the parties and refer them to the tribunal, as this would not solve the problems identified. In addition, it comments "that legal and evidentiary issues (e.g., identification of legally protected interests, causation, etc.) should be determined by the tribunals, not by damages experts. Only damages experts should be relied upon to establish the quantification of the damages caused by the infringement that the tribunal has found compensable. Unfortunately, the distinction between the two is often blurred."[55]

Canada believes that tribunals should consider factors that limit the amount of compensation, such as taking into account any contributory, intentional or negligent fault that mitigates the calculation of compensation. It recognises that these principles reflect customary international law and that further clarity on these principles would be helpful. Also, other factors limiting compensation are previous or received compensation for the same loss, restitution of property, or derogation or modification of the measure in breach of the obligation.[56]

Panama mentions that priorities could be considered for damage assessment. It should also be borne in mind that assessment, causality, foreseeability and proportionality depend

[54] Ibidem.
[55] Ibidem.
[56] Ibid. P. 3-4. The Commentaries to Article 39 of the ILC Articles were drafted at a time when the jurisprudence on these principles was limited, and the ISDS tribunal decisions that have been published since then contain significant inconsistencies.

on the facts of the case, so it is important to ensure that any mechanism for damages and compensation is balanced, realistic and achievable. [57]

Colombia attaches great importance to the development of basic provisions for damages, compensation, and balanced valuation methods. It considers that these should be included in a multilateral instrument on the reform of the ISDS system. Consequently, it supports working on relevant provisions (as far as possible with binding effect), on procedural issues. [58]

For Colombia, in all cases, monetary damages should not be greater than the loss proven by the claimant, or unlikely to occur, or based on probable or unrealistic expectations of profit. In addition, any compensation previously awarded to the claimant in connection with the same measures or reasons should be considered. Likewise, in the final assessment of damages, the tribunal will consider, for example, a comparison of multiple valuation methods and the monetary values reported by the claimant in economic statements required by the defendant for the realisation and operation of the covered investment. Also, an amount greater than the amount of damages sought by the claimant should not be awarded unless it reflects damages suffered or interest accrued when the claim was submitted to arbitration.[59]

The value of the compensation must equitably weigh the public interest and the investor's interest, "considering all relevant circumstances," and take into account the current and past use of the asset, its depreciation, the history of its acquisition, its market value, the purpose of the expropriation, the extent of the previous benefit obtained by the investor through the investment, and the duration of the investment, among others. In addition, the market value will be that of the time immediately before the adoption of the measures or immediately before the imminent adoption of the measures became public knowledge, whichever is earlier. The value date will be applied to assess the compensation to be paid regardless of whether the expropriation has been adopted for reasons of public utility or social interest, carried out in accordance with due process of law; and carried out in a non-discriminatory manner. On the other hand, the compensation will be calculated in freely usable currency, at the applicable exchange rate in effect on the date of calculation, including simple commercial interest fixed in accordance with market criteria for such currency, accrued from the date of expropriation until the date of actual payment.[60]

Switzerland seems to oppose the discussion on damages and compensation, because it "sees no pressing need for WGIII to undertake new work in this area" and juncture. It states that the agenda is loaded with a multitude of topics "and most of the issues addressed in the Note relate to substantive, rather than procedural issues."[61] Additionally, it notes

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[57] Panamá. *Comments by the Republic of Panama*. Regarding Initial Draft Note on Potential Reform in the Assessment of Damages and Compensation. November 16, 2021.
[58] Colombia. *Colombia's Comments on the Draft Provisions on Assessment of Damages and Compensation*. para. 2 & 4. November 15, 2021
[59] Ibid. par. 5-6.
[60] Ibid. para. 7-9.
[61] Switzerland. *Comments submitted by Switzerland on UNCITRAL's Initial Draft on Assessment of Damages and Compensation*. par. 1. 30 November 2021, par. 1

that this issue may be part of the grounds for appeal.[62] However, it comments on the legal framework, legal expropriation, illegal expropriation and violation of other standards, as well as on the assessment methodology, evidentiary requirements, interest and factors limiting the amount of compensation.

Switzerland adopts the distinction between legal and illegal expropriation. Regarding legal expropriation, it points out the importance of having consistent criteria to qualify state measures as expropriation. For this reason, it suggests deepening the criteria to distinguish compensable regulatory expropriation from non-compensable expropriation arising from the police and regulatory power of the State. Regarding illegal expropriation, it suggests covering possible differences in compensation arising from different categories of illegal expropriation, such as the date of valuation, the value of the expropriated property and the compensability of consequential losses, including the loss of *goodwill* or loss of business opportunities.

On compensation for breaches other than expropriation, it suggests exploring the relationship between the characterization of the legal interests of investors affected by State measures and the standard of compensation. It asks whether the frustration of legitimate expectations should entail compensation for the costs incurred in relying on the State's assurances (so-called "sunk costs") or should the investor be put in the situation it would have been in had the State complied with the assurances? Also, whether compensation is different depending on which sub-elements of FET are deemed to have been breached?[63]

On valuation methodology and evidentiary requirements, it points out that, "from an economic point of view, different valuation methodologies should in principle lead to the same result, as long as the object of valuation is properly selected." With respect to evidence, it is suggested that tribunals be guided by the rules of evidence when partial liability is found, but experts have only assessed damages on the assumption of total liability. Further, that it could be clarified to what extent a tribunal may make its own adjustments to the experts' valuation models or return them to the experts "without giving the impression of assisting the claimant in meeting its burden of proof." (par.7 and 9)

Concerning interest, Switzerland suggests addressing the connection between interest rate and risk and recalls that some tribunals emphasize that, where investors no longer control their investment, applying interest based on the WACC is inappropriate, as it would compensate the investor for the equity risk it no longer bears.[64] On the other hand, tribunals often award pre-award LIBOR interest, but given the phasing out of this rate, there is currently no clear guidance as to the surrogate that tribunals could use to adequately take into account the time value of money for major currencies and different maturity periods. (par. 10-11)

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[62] UNCITRAL. A/CN.9/WG.III/WP.241. *Communication from the Government of Switzerland.* March 4, 2024.
[63] Ibid. par. 6.
[64] ICSID. ICSID Case ARB/15/20. Cube Infrastructure Fund SICAV and others v. Kingdom of Spain. Award of June 26th, 2019. para. 537-539.

On the factors limiting the amount of compensation, Switzerland emphasises that the tribunals consider that they have a broad discretion to reduce compensation due to the following factors such as mitigation and contributory fault, and that they may determine the amount of such reductions without any apparent basis in expert evidence of quantum. It also highlights that, in the absence of compelling evidence, tribunals are often reluctant to find fault for mitigation because they consider that a claimant has an incentive to mitigate its loss. Given this, clearer criteria is needed on the applicability and impact of mitigation and concurrent fault on the value of compensation, as well as on other factors that may limit recoverable compensation, such as force majeure and state of necessity. Also, harmonize divergent approaches to double recovery when there are parallel international or national proceedings that create multiple prospects of recovery for the claimant. (par. 12-14)

E. Other comments

For the **International Law Institute -ILI**, it is not necessary to elaborate damage rules or compensation standards for different measures that violate different norms of international law, because the *but-for* method compensates damages for the precise violation, placing the injured party in the position it would have been in in the absence of the illegal measure. This method would already consider whether there is a total or partial, temporary or indefinite illegal impairment or loss of the investment. Likewise, fair market value can also be used - if properly applied - in other cases. (par. 12-13). [65]

The ILI draws attention to the problem of inconsistency and unpredictability of damage awards, which may be due to the lack of analysis and reasoning by the tribunals and the formulation of damages by experts who define the underlying principles of valuation, which are essentially legal.[66] Consequently, uncertainty in the field of liability leads to uncertainty in the assessment of damages. Consequently, evidence becomes essential to demonstrate the economic situation caused by the wrongful act and the economic position of the injured party but for that act, i.e. the reconstruction of the hypothetical normal course of events. (par. 21 and 30).

ILI supports the proposal to develop guidelines and standards on the legal framework for the assessment of damages and compensation based on existing rules and valuation methodologies, as this can facilitate a more consistent application, as long as it does not limit the freedom of evidentiary assessment and does not conflict with the rules of State responsibility. (par. 23 and 29).

The **ISCC, IIED and IISD** state that damage assessment and compensation fall squarely within the purview of WG III and that, because of its interrelationship with other issues, it is difficult to imagine an effective reform outcome that does not significantly address these issues in a holistic manner. Moreover, a limited technical response to specific

[65] International Law Institute. Experts comments on Assessment of Damages and Compensation. November 9, 2021.
[66] Ibid. par. 8.

problems will not solve the important issues at stake.[67] Thus, a binding multilateral treaty that clarifies, integrates or modifies the provisions of IIAs is the most effective means of resolving the issues with respect to the calculation of damages and compensation. They also note that guidelines and standards can help fill gaps not covered by existing treaties but may be less effective in changing long-established dispute settlement practices.

The organizations highlight the speculative nature of the DCF, its assumptions and the inconsistent approach of arbitration tribunals to assess country and other risks and suggests studying the compensation practices of political risk insurers, which link compensation to a percentage of book value, such as that used by the Overseas Private Investment Corporation, reflected in 51 Fed. Reg. 3438, Jan. 27, 1986.

Finally, they do not agree with the inclusion of restitution, but they do agree to study the possibility of working on the use of valuation methods, such as limiting compensation to the amount actually invested, and on the integration of contextual factors in the calculation of compensation.

IV. Conclusion

The concerns expressed by WG III members in the various documents submitted and the discussions held during the meetings on the issues relating to the assessment of damage and the determination of compensation were partly used for their inclusion in the draft provisions on procedural and cross-cutting issues prepared by the Secretariat. However, not all the issues were included in the final version and a discussion on the relevance of their inclusion in the next draft of the Procedural and Cross-Cutting Issues is still pending.

In general, the discussions that have taken place among the UNCITRAL WG III members up to 2022 on the various issues that arise in the context of damage assessment by tribunals show a common understanding of the concerns and issues that could be addressed in the remaining negotiations up to September 2025. Some issues that may still need to be agreed upon are the type of legal instrument in which the issues could be included, a treaty or guidelines, and which issues would be included in the treaty or guidelines.

WG III has one year to make the decisions that could lead to a reform of the ISDS system that will truly address the problems of correctness, consistency, and predictability of tribunal awards. For this reason, clarity and efficiency in the further discussion among WG III members will be now needed.

[67] Columbia Center on Sustainable Investment (CCSI), the International Institute for Environment and Development (IIED), and the International Institute for Sustainable Development (IISD). *Submission to UNCITRAL Working Group III on ISDS Reform.* November 12, 2021. P. 1-2