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Foreword

We are pleased to present the latest edition of *Quantum Quarterly,* a publication of King & Spalding's International Arbitration Practice Group. This edition kicks off with an interview with Howard Rosen of Secretariat in Toronto. Howard is one of the world's foremost quantum experts in the international disputes space, particularly in assessing the value of projects in the extractive natural resources sector. Howard's views on quantum issues will be of great interest to practitioners, arbitrators, and fellow experts alike.

Next we feature a series of case notes focusing on the quantum holdings of recent awards. We are particularly proud of the *Union Fenosa Gas v. Egypt* case, in which the firm secured what was at the time of its issuance the largest damages award in ICSID's 54-year history.

This edition also features two notable commercial awards, including *Vantage v. Petrobras,* in which the tribunal took the unusual step of using the claimant's weighted average cost of capital ("WACC") as the interest rate—a development that this publication enthusiastically embraces as long overdue for appropriate cases.

Finally, we welcome as our new co-editor Jessica Beess und Chrostin, a senior associate in our New York office. Jessica brings a wealth of experience and enthusiasm to the position, and we are glad to have her. We hope you enjoy this edition. As always, we welcome any feedback you may have. All the best.

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An Interview with Howard Rosen

Tell us a bit about your background and practice.

Shortly after qualifying as a Chartered Accountant and Chartered Business Valuator, I began my own firm quantifying economic damages arising from disputes predominantly in Canada and the US (cross-border).

In addition, I started a small venture capital/private equity investment company so that I would have exposure to the transactional world and be able to speak as an expert from practical experience in determining value.

My firm was acquired by a large international accountancy firm, and from there I expanded the damages practice globally. Since then I have worked building economic damages practices in international consultancies around the world.

I joined Secretariat International at the end of November 2018 to expand the economic damages practice. Secretariat is a global leader in the Construction Disputes world with experts in 15 offices in eight countries. Currently we have economic damages experts in the US, Canada, and Western Europe, with imminent expansion plans in the Middle East and Asia. Our Damages and Financial Investigations practice is made up of experts in the fields of Accounting, Finance, and Economics.

How did you end up working as a quantum expert in international arbitration?

In 1994, NAFTA came into effect, and in 1996, the first NAFTA dispute was filed. I was retained as the financial damages expert on behalf of the Claimants. After this initial case, I shifted the focus of my Canadian practice to Investment Treaty disputes, and shortly thereafter, Commercial International Arbitration. As foreign direct investment and joint venture investing continued to spread globally, I found I was being called as an expert on cases around the world in a wide range of businesses. Since most disputes were of a large nature, they tended to involve businesses that required substantial capital investment. This led to many cases in the areas of natural resources, infrastructure, real estate, and construction.

What do you consider to be the most interesting recent developments in international arbitration cases concerning damages?

I have seen two developments that I think are worth mentioning.

I find more recently that counsel and arbitrators have become more sophisticated in their understanding of damages issues. We have witnessed an increasing willingness of arbitrators to engage with the evidence and not shy away from drawing their own conclusions, rather than following the position put forth by one expert or the other. I think this is a natural evolution that has arisen due to the "ships passing in the night" phenomenon that is frequently referred to when assessing expert reports. My own sense of this is that this phenomenon arises from the instructions given to experts by counsel, or the misconception some experts have about their role and their duty to the arbitral tribunal.

The second development, and somewhat related to the point regarding sophistication, is the consideration or acceptance of evidence by arbitral tribunals that is more focused on how the market perceives value, rather than a completely academic or theoretical approach to value. We now read about awards where arbitral tribunals are trying to reconcile what they see in the evidence to signals from the market. I think it is a very positive development.

As an expert, do you feel that arbitrators in investment arbitration cases approach damages differently from arbitrators in commercial cases?

In my experience, investment treaty arbitrations tend to be more complex from a damages point of view due to the focus on two sets of framework issues: "country risk" and "social license risk," and the theory of "full reparation" as distinct from "fair market value." In commercial cases, the contract sets out the commercial terms (well or badly drafted), which create the framework for the analysis of damages. There may be other legal framework issues that have an impact on how the value of damages should be considered, but both of these framework issues are largely a matter of legal instruction by counsel.

The party and counterparty risks are readily identifiable and as such, in most cases, can be quantified with many areas of agreement between the experts. In investment treaty cases, country risk is not a legal instruction, nor is how to approach the question of social license. The investor is faced with these risks at the time of investment and at the time of the "measures" giving rise to the investment treaty dispute. How these have changed over time may impact the calculation of damages, and different experts may approach the quantification of these risks in different ways. Additionally, the concept of full reparation, from a valuation point of view, is unique to the investor, while the concept of fair market value is not.

These factors tend to complicate the quantification of damages in investment treaty cases, and thus, you do not observe a consistent approach by arbitrators on these issues.

> *"My tips for counsel are to ensure that experts are asked to opine only on matters that are truly matters requiring expertise, and then to ensure that their experts opine only on areas in which they are truly expert."*

Any tips for counsel advocating damages issues?

Over the last 35 years, I have seen a trend to overuse experts, and to try and push experts to advocate issues in their client's case. My tips for counsel are to ensure that experts are asked to opine only on matters that are truly matters requiring expertise, and then to ensure that their experts opine only on areas in which they are truly expert (the expression I like to use is "ensure experts swim in their own lane"). The other tip relates to language in expert reports that is aggressive or advocates factual or legal matters of the parties. Counsel should avoid trying to "edit" expert reports to include argument that is advocacy, and if it is observed, should suggest that experts remove it from their reports.

Recent Damages Awards

Olin Holdings Limited (Cyprus) v. State of Libya, (ICC Case No. 20355/MCP)

Date of the Award
May 25, 2018

The Parties
Olin Holdings Limited (Cyprus) (the "Claimant" or "Olin"), State of Libya (the "Respondent" or "Libya")

Sector
Food and Beverages

Applicable Treaty
Agreement on the Promotion and the Reciprocal Protection of Investments between the Government of the Republic of Cyprus and the Great Socialist Libyan Jamahiriya dated 30 June 2004 (the "BIT")

Members of the Tribunal
Mrs. Nayla Comair-Obeid (president), Mr. Roland Ziadé (Claimant's appointee), and Mr. Ibrahim Fadlallah (Respondent's appointee)

Background

In 1997, Libya enacted Law No. 5 for the Promotion of Investment of Foreign Capital (the "Libyan Foreign Investment Law"). Following the enactment of the Libyan Foreign Investment Law, Olin decided to invest in a dairy and juice factory near Tripoli and obtained all necessary permits and licenses. To carry out its investment, Olin partnered with PROLAC, a major French milk powder producer and exporter, and with ACTINI, a French manufacturer of sterilizing equipment. Olin completed the construction of its factory toward the end of 2006. After Olin had completed construction of its factory and was ready to begin production, Tripoli's People Committee for Housing & Utilities issued an eviction order informing Olin that its factory was being "dispossessed" and asking Olin to vacate the factory within three days. The Committee's order was issued pursuant to Decision No. 241 of 2006, which in turn was issued by the General People's Committee on October 19, 2006, whereby the General People's Committee expropriated a swath of land including Olin's factory.[1]

Despite the eviction notice, Olin's license to operate was renewed on November 26, 2006. Throughout the following three years (*i.e.,* from 2006 to 2009), Olin sought an exemption from Decision No. 241. During this time, two of Olin's direct competitors—namely, Al-Aseel Juice Plant and OKBA Dairy Factory—received exemptions from Decision No. 241. On April 13, 2010, the Tripoli Court of Appeal canceled Decision No. 241, declaring it unlawful under Libyan law because it did not follow the process for expropriation set forth in the Libyan Foreign Investment Law. Olin sought redress before the South Tripoli Court for all damages suffered as a result of Decision No. 241, but the South Tripoli Court decided no indemnification was due.[2] On July 3, 2014, Claimant filed a request for arbitration before the ICC under the BIT, claiming US$ 147,882,000 as compensation for the harm it suffered as a result of Libya's alleged breaches of the BIT and the Libyan Foreign Investment Law.[3] In the Award, the Tribunal found Libya had breached its obligations under Articles 2(2), 3, and 7 of the BIT. The Tribunal dismissed Libya's counterclaims.

Jurisdiction and Liability

On June 28, 2016, the Tribunal issued a partial award on Jurisdiction, finding jurisdiction over Claimant's claims, joining Libya's additional objections regarding the decisions handed down by Libyan courts to the merits, and dismissing Libya's claim for damages resulting from the allegedly fraudulent and abusive nature of the arbitration.[4] That same day, the Tribunal issued a Partial Award on the Advance on Costs. In its Partial Award on the Advance on Costs, the Tribunal ordered Libya to pay Claimant US$ 325,000 plus simple interest, calculated at the 12-month US$ LIBOR benchmark rate. The Tribunal reserved determination of all other claims pertaining to jurisdiction and the advance on costs until the issuance of the Final Award.[5]

Quantum

As noted above, the Tribunal concluded Libya breached Articles 2, 3, and 7 of the BIT. Having established these breaches, the Tribunal proceeded to assess how Olin should be compensated for its losses, if at all. The Tribunal subdivided its quantum analysis into three main issues: (a) assessment of whether a causal relationship existed between Libya's actions and Olin's purported damages; (b) the appropriate methodology for quantifying Olin's damages; and (c) the proper application of that methodology.

A. Causation

The Tribunal based its quantum decision on an analysis of (i) the causal link between Libya's wrongful conduct and Olin's underperformance; and (ii) the causal link between Libya's wrongful conduct and Olin's cessation of activities in October 2015.[6]

At the outset, the Tribunal declared Olin had to affirmatively demonstrate Libya's breaches proximately caused Olin's underperformance, *i.e.,* that Olin's underperformance was a foreseeable consequence of Libya's acts and omissions.[7] To reach that point in the analysis, though, the Tribunal first proceeded to ascertain the harm suffered by Olin. To answer this question, the Tribunal distinguished between two time periods during which Libya harmed Olin by interfering with its activities:

- "First, the period running from November 2006 (when Olin's managers learn[ed] about the Expropriation Order) to June 2011 (when Olin was able to register title over the land on which its factory was built); and

- Second, the period following June 2011, during which Libya implemented a number of measures in breach of the FET standard . . ."[8]

Based on the facts as pleaded by the parties, the Tribunal concluded Olin had successfully proved it had suffered harm as a result of Libya's acts and omissions predating June 2011. Olin's harm fell into the following categories:

- Uncertainty as to whether Olin's factory would be destroyed and relocated, resulting in "abandonment of new investments in Olin's business, stoppages in production and postponement of marketing campaigns which had a paralyzing effect on Olin's activities";[9]
- Inability to plan and manage its investments;
- Loss of Olin's first-move advantage; and
- Strain in its relationship with stakeholders, lenders, suppliers, and distributors.[10]

Separately, the Tribunal concluded Olin had suffered harm following June 2011. Specifically, Olin had been unable to obtain a customs clearance to import its new production line and had been unable to repatriate its profits or access foreign currency in-country. Having defined Olin's harm, the Tribunal proceeded to analyze the causal link between Libya's measures and Olin's harm, which it had no problem finding. In sum, the Tribunal concluded Olin had established Libya's measures were both the but-for cause and the proximate cause of Olin's underperformance. Notwithstanding that conclusion, the Tribunal also found that Olin's business decisions relating to the purchase of machinery contributed to Olin's underperformance such that Olin's own behavior must be considered when assessing its damages.

With regard to Olin's cessation of activity in October 2015, the Tribunal was unable to conclude that the lack of access to foreign currency and other measures enacted by Libya were the only driving force behind the cessation of Olin's activities in 2015.

B. Valuation Methodology

The Tribunal applied the well-worn principles set forth in the Chorzow case and the ILC Articles on State Responsibility. According to the former, damages "shall wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed."[11] Pursuant to the latter, a State is required to "make a full reparation for the injury caused by the internationally wrongful act [covering] any financially assessable damage including loss of profits insofar as it is established."[12] With these principles in mind, the Tribunal concluded that the DCF methodology suggested by Olin's expert, FTI, was the most appropriate. Indeed, in the Tribunal's opinion, the DCF methodology was the only methodology that would put Olin "in the financial position in which it would have found itself in the absence of breach or breaches."[13] Under the DCF methodology, the Tribunal was to compare "(a) the value to Olin of the cash flows that it has generated and will in fact generate given the breaches (the 'actual scenario') and (b) the value to Olin of the cash flows that it would have generated but for Libya's breaches (the 'but-for scenario')."[14]

C. Application of the Valuation Methodology

In applying FTI's methodology, the Tribunal assessed the existence of past and future losses before moving on to drawing conclusions regarding Olin's losses, and quantifying them. The Tribunal agreed with FTI's conclusion that Olin's damages predating 2016 could be assessed with a reasonable degree of certainty by comparing Olin's performance with that of similarly situated companies in similar markets, as well as its competitors in Libya during the same period. With regard to Olin's future losses, however, the Tribunal was not convinced that Olin had proved these losses with sufficient certainty, or that the losses could be attributed to Libya. The Tribunal therefore focused specifically on Olin's past losses in the Award.

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In the interest of caution, and noting the "bar against speculative damages," the Tribunal rejected FTI's first but-for scenario, opting instead to credit FTI's 50% market-share approach. Under the 50% approach, FTI estimated that Olin had suffered losses ranging from EUR 24.3 million to EUR 27.8 million. The Tribunal considered these damages to be too high, though, and imposed a downward adjustment of 25% to FTI's damages calculation.[15] The total damages awarded by the Tribunal after the adjustment amounted to EUR 18.225 million.

Interest and Costs

The Tribunal awarded Olin simple interest at a rate of 5% starting from the date of the Award until final payment. With regard to costs, the Tribunal ordered Libya to pay Olin US$ 773,000 for the costs of the arbitration, as fixed by the ICC Court. Finally, with regard to legal costs, the Tribunal awarded Olin 75% of its legal costs and expenses, amounting to EUR 1,069,687.70, and concluded that Libya would bear its own legal costs.

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1 *Olin Holdings Limited (Cyprus) v. State of Libya,* ICC Case No. 20355/MCP, Final Award, May 25, 2018 ("Award"), ¶¶ 79-91.

2 Award, ¶¶ 96-120.

3 Award, ¶ 17.

4 Award, ¶ 38.

5 Award, ¶ 40.

6 Award, ¶ 432

7 Award, ¶ 435.

8 Award, ¶ 438.

9 Award, ¶ 439.

10 Award, ¶ 439.

11 Award, ¶ 473.

12 Award, ¶ 473.

13 Award, ¶ 475.

14 Award, ¶ 474 (emphasis and internal punctuation omitted).

15 Award, ¶¶ 498-502.

Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain, SCC Arbitration (2015/063)

Date of the Award
February 15, 2018

The Parties
Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR ("Novenergia" or "Claimant"), and the Kingdom of Spain ("Respondent")

Sector
Energy (solar photovoltaic)

Applicable Treaty
Energy Charter Treaty ("ECT")

Members of the Tribunal
Mr. Johan Sidklev (chairperson), Prof. Antonio Crivellaro (Claimant's appointee), and Judge Bernardo Sepúlveda-Amor (Respondent's appointee)

Background

This case concerns Spain's alleged breach of the fair and equitable treatment ("FET") standard under the ECT by fundamentally changing the renewable energy incentives regime under which Novenergia made its investment.

In September 2007, Novenergia acquired and developed seven solar photovoltaic ("PV") plants in Spain.[1] All of these plants were registered in the "Special Regime" under Royal Decree 661/2007 ("RD 661"), an incentives regime enacted by Spain to attract significant investment in its renewable energy sector. The Special Regime provided attractive feed-in tariffs ("FiTs") to PV investors for the production of renewable energy. Moreover, RD 661 guaranteed the incentives for a specific period; for example, in the case of PV plants, the regime guaranteed fixed FiTs for the entire life of the facilities.[2]

From 2010 onward, Spain began adopting a series of measures that modified the Special Regime and reduced the amount of support to renewables (the "2010 measures"). Between 2013 and 2014, Spain introduced additional measures that effectively abolished the Special Regime and introduced a brand-new compensation system that was applied retrospectively to Novenergia's plants (the "New Regime").[3]

Jurisdiction and Liability

The Tribunal dismissed a series of jurisdictional objections raised by Spain, including the so-called intra-EU objection. However, in line with prior awards against Spain, the Tribunal upheld the objection in relation to one of the 2010 measures by applying the tax carve-out in the ECT.[4]

On the merits, the Tribunal held that Spain breached the FET standard by adopting the New Regime, which it described as a series of "radical and unexpected" changes that ultimately abolished the original incentives regime under which Novenergia had invested.[5] The Tribunal dismissed Novenergia's claims in relation to the 2010 measures (for example, the reduction of the number of years for which the FiTs would be paid). In doing so, the Tribunal held that Novenergia could not have reasonably expected that there would be *no changes at all* to the regime, and thus it considered that the earlier measures did not amount to a treaty breach.[6] The Tribunal also dismissed the umbrella clause and expropriation claims, which were brought as alternatives to the FET claim.[7]

Quantum

A. Compensation Standard

The ECT does not set out a standard of compensation for breaches of the FET obligation. It does set out a compensation formula in Article 13, which applies in relation to expropriation.[8] Given that the Tribunal had dismissed Novenergia's expropriation claim, it did not consider it appropriate to use Article 13 as guidance. Instead, the Tribunal looked at general principles of customary international law to determine the relevant compensation standard.[9]

Relying on Article 13 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts and on the *Factory at Chorzow* case, the Tribunal determined that under the principle of full reparation, the compensation should place the investor in the same situation in which it would have been "but for" Respondent's breach. Thus, compensation must "wipe out" all consequences of Spain's unlawful acts.[10]

B. Compensation for Breach of the FET Standard of Treatment

Novenergia claimed the following losses: (1) €51.4 million under the expropriation claim (allegedly the fair market value of Novenergia's investment before the expropriation occurred), and (2) €61.3 million under the Article 10 claims (FET and Umbrella Clause).[11] Given that the Tribunal had dismissed Novenergia's expropriation claim, it did not assess the investment's fair market value.

Claimant's experts calculated the Article 10 damages using the discounted cash flow ("DCF") methodology. Thus, €61.3 million was the result of an *ex post* DCF valuation as of September 15, 2016.[12]

According to Claimant, the DCF method was the most appropriate method for the following reasons: (1) the value of Novenergia's investments "stems from the cash flow generation capabilities of PV plants, which have [a] sound history of eight years of operations"; (2) the DCF method is particularly appropriate "to value companies whose revenues are defined by law or regulation," such as the FiT regimes, given that the cash flows are more predictable; (3) it is the preferred approach by leading financial authors for income-producing assets; and (4) it is "the most generally accepted technique in valuation analysis" and "widely accepted as a tool for the calculation of damages in disputes."[13]

Claimant relied on several investment treaty cases, including *Vivendi v. Argentina*, to argue that Spain's proposed asset-based approach was inappropriate and had been "routinely rejected by arbitral tribunals" such as *Tidewater v. Venezuela* and *Enron v. Argentina.*[14]

Further, Claimant argued that its damages were rigorously calculated based on years of historical data (under both the original regulatory regime and the New Regime). Novenergia's experts calculated damages by comparing "the 'actual scenario,' taking into account the replacement of the Special Regime with the [New Regime], and a 'but-for scenario' in which the challenged measures had not been enacted," *i.e.*, if Claimant's plants had continued to receive the tariffs under RD 661.[15]

Finally, Claimant argued that Spain's "corrected" DCF calculation presented three major errors, resulting in an 80% disparity with Novenergia's calculations: (1) Spain included a much higher regulatory risk premium in the discount rate in the but-for scenario than in the actual scenario; (2) it improperly included an asymmetric illiquidity discount; and (3) it duplicated the value of operating costs in the but-for scenario and ignored the reduction in costs from 2010 onward.[16]

By contrast, Spain argued that Novenergia's estimated damages were absolutely speculative. In doing so it relied on Spanish Supreme Court judgments in cases brought by domestic renewable energy investors, in which the Supreme Court held that "extrapolations into the future lack the necessary rigor and security."[17] In response to this argument, Novenergia stated that domestic court decisions were irrelevant, as the Supreme Court

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was adjudicating matters under Spanish law and not under international law.[18]

Spain further argued that the DCF method was not appropriate given that the historical period was not sufficiently long. Moreover, citing *Rusoro v. Venezuela,* Spain argued that this method needed to be subject to a "sanity check," which had not been carried out by Novenergia.[19]

Finally, Spain's experts provided a "corrected" DCF calculation that concluded that the disputed measures had actually had a positive financial impact of €0.4 million on Novenergia's investments.

The discrepancy between the two DCF calculations was based on the different parameters used: (1) Spain used June 20, 2014, as its valuation date, while Novenergia used September 15, 2016; (2) regarding discount rates, Spain considered that the but-for scenario would entail greater risk and uncertainty than the current scenario (arguing that the New Regime was far more stable than the original regime) and therefore applied a higher risk premium in the but-for scenario; (3) Spain applied illiquidity discount rates that reduced the but-for scenario by 17% and the actual scenario by almost 12%;[20] and (4) regarding operating costs, Spain did not take into account the actual reduction of costs from 2010 onward, because it considered that the reduction had been a consequence of the New Regime.[21]

The Tribunal accepted Claimant's position regarding the appropriateness of the DCF method as the preferred valuation method for income-earning assets, noting that it was broadly accepted by arbitral tribunals.[22] It further noted that the Spanish Supreme Court case law on damages was irrelevant to the arbitration.

Regarding Spain's "corrected" DCF calculation, the Tribunal said that it was "convinced" that the New Regime had not put Novenergia in a better position than it had been in under the Special Regime. First, with respect to the discount rates, the Tribunal determined that it was not reasonable to conclude that the level of risk was higher under the Special Regime than it was under the New Regime.[23]

Second, the Tribunal found Spain's arguments regarding the illiquidity discount unconvincing and not sufficiently substantiated. Third, the Tribunal concluded that it was unconvinced by Spain's arguments regarding operating costs, given that Claimant had already identified and taken into account three operating cost items that were indeed reduced as a consequence of the New Regime. Thus, it concluded that there was no reason why the actual costs (which were supported by evidence) should not "constitute the correct evaluation element in the but-for scenario."[24]

The Tribunal awarded €53.3 million (of the €61.3 million claimed by Novenergia), after deducting the amounts claimed for the 7% tax (for which the Tribunal lacked jurisdiction) and the 2010 measures, (which the Tribunal held did not breach the FET standard).

Interest and Costs

Claimant sought pre- and post-award compounded interest at a rate of 7.03%, which it claimed to be equivalent to the cost of equity.[25] Spain objected to this rate, alleging that it had no economic sense.[26]

In the Tribunal's opinion, the interest rate should be "a commercial and risk-free" yield interest rate in Spain. Accordingly, it concluded that the 10-year Spanish yield bond was the most appropriate rate. At the time of the award, the 10-year Spanish bond was approximately 1.5%; therefore, the Tribunal awarded pre- and post-award interest at 1.5% compounded monthly.[27]

With respect to costs, Novenergia claimed more than €3 million, which the Tribunal considered to be "inadequately justified." Taking into account that Novenergia lost on one of the jurisdictional objections and received less compensation than requested, the Tribunal awarded Novenergia €2.6 million. This sum included the costs of the arbitration (the SCC's and the Tribunal's fees and expenses), which amounted to approximately €600,000.[28]

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1 Final Award dated February 15, 2018, *Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain,* SCC Arbitration (2015/063), (hereinafter "Final Award") ¶¶ 539-540.

2 Final Award, ¶ 101. The regime guaranteed a specific tariff for the first 25 years, and a lower tariff thereafter.

3 Final Award, ¶ 691.

4 Final Award, ¶¶ 516-525. The tax carve-out generally excludes tax measures from the substantive protections of the BIT.

5 Final Award, ¶ 695.

6 Final Award, ¶¶ 688-689.

7 Final Award, ¶¶ 715-716 and 759-763.

8 Article 13.1 ECT provides that the compensation "shall amount to the fair market value" immediately before the expropriation.

9 Final Award, ¶ 804.

10 Final Award, ¶¶ 806-809.

11 Final Award, ¶¶ 768, 810.

12 Final Award, ¶ 768.

13 Final Award, ¶ 774.

14 Final Award, ¶ 775.

15 Final Award, ¶ 772.

16 Final Award, ¶ 781.

17 Final Award, ¶¶ 785-787.

18 Final Award, ¶ 773.

19 Final Award, ¶¶ 789-790, 817.

20 Final Award, ¶ 833.

21 Final Award, ¶¶ 796-800, 776.

22 Final Award, ¶¶ 818, 820-821.

23 Final Award, ¶ 833.

24 Final Award, ¶¶ 833-836.

25 Final Award, ¶¶ 769-770.

26 Final Award, ¶ 802.

27 Final Award, ¶¶ 846-849.

28 Final Award, ¶¶ 857-858.

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Foresight Luxembourg Solar 1 S.A.R.L., Foresight Luxembourg Solar 2 S.A.R.L., Greentech Energy Systems A/S, GWM Renewable Energy I S.P.A., and GWM Renewable Energy II S.P.A. v. The Kingdom of Spain, SCC Case No. 2015/150

Date of the Award
November 14, 2018

The Parties
Foresight Luxembourg Solar 1 S.A.R.L., Foresight Luxembourg Solar 2 S.A.R.L., Greentech Energy Systems A/S, GWM Renewable Energy I S.P.A., and GWM Renewable Energy II S.P.A. ("Claimants")[1]

The Kingdom of Spain ("Respondent" or "Spain")

Sector
Energy (concentrated solar power)

Applicable Treaty
Energy Charter Treaty 1994 ("ECT")

Members of the Tribunal
Dr. Michael Moser (president), Prof. Dr. Klaus Michael Sachs (Claimants' appointee), and Dr. Raúl Emilio Vinuesa (Respondent's appointee)

Background

This dispute arose from a series of regulations enacted by Spain between 2010 and 2013 that reduced the value of investments the Claimants had made in Spain's renewable energy sector, specifically the concentrated solar power ("CSP") sector.

Beginning in the 1990s, Spain undertook a series of efforts to increase the production of renewable energy in Spain in order to comply with its obligations under certain European Union ("EU") directives and the Kyoto Protocol. To incentivize investment in Spain's nascent renewable energy sector, the country adopted a feed-in tariff ("FiT") regime that succeeded in attracting a significant number of investors who benefited (at least initially) from favorable business conditions in industries such as CSP.[2] In reliance on Spain's FiT regime, the Claimants acquired an interest in three photovoltaic facilities that operated in central Spain. All facilities were registered under the FiT regime and benefited from the tariff.

Because the Spanish FiT regime did not pass the cost of the system to end consumers, over time, the scheme exacerbated a tariff deficit reflecting the difference between the amount retail customers paid for electricity and the regulated costs of the Spanish electricity system.[3] From 2010 onward, Spain took multiple legislative measures allegedly to reduce this tariff deficit. These regulatory changes negatively impacted the Claimants' investments. In this arbitration, the Claimants argued that the regulatory changes Spain adopted breached the protections enshrined in Part III of the ECT, entitling the Claimants to compensation.[4]

Jurisdiction and Liability

Spain raised an intra-EU objection to the Tribunal's jurisdiction. The Tribunal dismissed this primary jurisdictional objection, holding, *inter alia*, that the dispute mechanism established under Article 26 of the ECT was not incompatible with EU law as claimed by the Respondent.[5] Further, the Tribunal indicated that the recent *Achmea* judgment had no repercussion on intra-EU ECT disputes, endorsing previous holdings on this issue (e.g., *Novenergia v. Spain* and *Masdar v. Spain*).[6]

On liability, the Tribunal ruled—by a majority—that Spain breached the Fair and Equitable Treatment ("FET") standard set forth in ECT Article 10(1). The Tribunal held that Spain's enactment of the new regulatory regime breached the investors' legitimate expectations of regulatory stability, and required that Spain compensate the investors.[7] The Tribunal, however, held that the disputed measures did not amount to expropriation because the Claimants had not lost legal title and remained "untouched" owners of the photovoltaic facilities.[8]

Quantum

The Claimants sought €58.2 million in damages for the diminution of market value of their investment in the three Spanish photovoltaic facilities.[10] To calculate the quantum of compensation, they proposed to use the Discounted Cash Flow ("DCF") valuation method. The Claimants argued that this was the appropriate method to assess the investment value in the "but for" analysis (*i.e.*, the counterfactual scenario) in which Spain did not introduce the disputed measures. The Claimants' quantum expert therefore compared the position in which the investment was finally sold under the new regime, and the hypothetical forecast of operational cash flows of the photovoltaic facilities. According to the Claimants' expert, tribunals deciding cases regarding the same measures enacted by Spain strongly endorsed the DCF approach.[11] The expert further asserted that, in this case, the future cash flows were highly predictable, particularly because the Spanish FiT regime defined the price at which electricity was sold in the counterfactual scenario.[12] The Claimants also requested the Tribunal to award pre and post-award compound interest at the highest lawful rate.[13]

By contrast, the Respondent claimed that the DCF valuation method was not suitable to calculate the quantum of damages in the arbitration. The Respondent's expert stated that "DCF is flawed because it fails to consider the main structural features of the Spanish electricity system in the context of the tariff deficit that existed … and is highly speculative."[14] The Respondent's expert asserted that the Regulatory Asset Base ("RAB") valuation method was more appropriate because it was frequently used in regulated sectors such as the renewable energy industry. It also argued that under the Spanish energy regime, the Claimants had no guarantee of or right to a fixed tariff but only to a reasonable rate of return. Under the RAB method, the Claimants' investment showed no discrepancy between the actual and counterfactual positions in the long run. The Respondent's expert further criticized the DCF methodology because it assumed that the tariffs would remain unaltered as of the date on which the Claimants invested—which Spain claimed was a time of "high regulatory risk"[15]—and failed to consider the structural imbalance of the Spanish electricity system. In the alternative to a RAB-based valuation, the Respondent proposed to use the DCF methodology, but only under the assumption that the Claimants would always obtain returns close to the market return.[16]

The Tribunal noted that the Claimants sought damages for the decreased market value of their equity interest in the Spanish photovoltaic facilities resulting from the disputed measures.[17] To calculate this diminution, it used the proposed DCF methodology, albeit with some adjustments.

The majority held that DCF was suitable to calculate the future financial performance of the three facilities. Citing the *Novenergia v. Spain* award, the majority stated that the DCF methodology "is widely supported in professional literature, but more importantly, the method has been broadly accepted by numerous arbitral tribunals as 'the only method which can accurately track value through time.'"[18] The majority agreed with the Claimants that the future performance of the facilities was reasonably predictable, making the Claimants' quantum model sufficiently reliable.

The Tribunal proceeded to reject the Respondent's RAB-based method because the RAB valuation concluded that the disputed measures did not cause any loss to the Claimants, as they "were only ever entitled to a regulated rate of return that fluctuated with interest rates."[19] The Tribunal found this unpersuasive since the Claimants had certainly invested under Spain's beneficial regime, which offered fixed tariffs and not only a "reasonable return," a concept that was later introduced through changes to the regulatory regime.

Guided by the Claimant's model, the Tribunal reasoned that the correct formula to use to calculate damages should compare (i) the hypothetical value of the Claimants' equity interest in the three facilities based on the DCF method, and (ii) the actual market value of the investments after the introduction of the disputed measures.[20] To obtain the actual market value, the majority looked at the arm's-length sales price of the Claimants' equity interest in the photovoltaic facilities at the time the sale occurred, between 2015 and 2016.

The majority made some additional adjustments to the Claimants' model. First it acknowledged that the Claimants had not itemized the damages caused by each of the regulatory measures.[21] The lack of a detailed breakdown excluded a number of historical losses before the actual date of assessment. Second, the arbitrators reduced the operating life forecast of the photovoltaic facilities from 35 to 30 years. Taking those modifications into account, the Tribunal issued a €39 million award in favor of the Claimants.

Interest and Costs

After noting that the ECT is silent on the question of interest, the Tribunal endorsed the *Asian Agricultural Products v. Sri Lanka* tribunal's holding that "interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility became engaged." The Tribunal awarded a pre-award interest rate of 1.4%, compounded monthly, and a post-award rate of 3.5%, also to be compounded monthly until payment is satisfied.[23]

With respect to costs, since the Claimants had substantially prevailed both on the merits and on jurisdiction, the Tribunal decided to award the Claimants the entire cost of the arbitration.[24]

Partial Dissenting Opinion

Arbitrator Raúl Emilio Vinuesa (Respondent's appointee) rendered a partial dissenting opinion setting forth the following arguments: (i) EU law is international law, and as such it should be considered with respect to Respondent's jurisdictional objection and it also should be applied to the merits of the dispute; (ii) the majority's disregard of EU law poses a problem for establishing the FET violation because, under EU law, Spain's state aid (*i.e.*, the FiT) was illegal; and (iii) the Claimants failed to undertake proper due diligence under EU law and state aid under Spanish law. Arbitrator Vinuesa thus dissented with respect to the application of the law, the findings on liability, and the allocation of damages, interests, and costs.

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1 King & Spalding represented Claimants.

2 *Foresight Luxembourg Solar 1 S.A.R.L., et al v. The Kingdom of Spain Final Award*, Nov. 14, 2018 ("Final Award")¶ 56.

3 Final Award, ¶ 114.

4 Final Award, ¶ 151.

5 Final Award, ¶ 207.

6 Final Award, ¶ 221.

7 Final Award, ¶ 398.

8 Final Award, ¶ 429.

9 Final Award, ¶¶ 439-441.

10 Final Award, ¶ 442.

11 Final Award, ¶ 451.

12 Final Award, ¶ 451 (the Claimants refer specifically to Royal Decree 661/2007, which set forth the fixed feed-in tariffs (FiTs) for qualifying photovoltaic facilities).

13 Final Award, ¶ 453.

14 Final Award, ¶ 459.

15 Final Award, ¶ 462.

16 Final Award, ¶ 471.

17 Final Award, ¶ 481.

18 Final Award, ¶ 477.

19 Final Award, ¶ 483.

20 Final Award, ¶ 488

21 Note that the majority did not deem all of Spain's regulatory changes to be in violation of the ECT.

22 Final Award, ¶ 544.

23 The Tribunal took into account both the Respondent's cost of borrowing (five-year Spanish government bond 0.4%-1.4%) and the Claimants' cost of borrowing (cost of debt 3.5%-4.5%).

24 Final Award, ¶ 560.

Unión Fenosa Gas, S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/14/4

Date of the Award
August 31, 2018[1]

Decision on Annulment
Pending

The Parties
Unión Fenosa Gas, S.A. ("Claimant" or "UFG"),[2]
Arab Republic of Egypt ("Respondent" or "Egypt")

Sector
Gas (natural gas)

Applicable Treaty
Bilateral Investment Treaty between Spain and Egypt ("BIT" or "Treaty")

Members of the Tribunal
V.V. Veeder (president), J. William Rowley (Claimant's appointee), Mark Clodfelter (Respondent's appointee)

Background

On August 1, 2000, representatives of the Egyptian General Petroleum Corporation ("EGPC") and Unión Fenosa Desarrollo y Acción Exterior, S.A. ("UFACEX"), entered into a Sale and Purchase Agreement ("SPA") whereby EGPC would provide UFACEX with certain quantities of natural gas. The SPA was endorsed by the Egyptian Minister of Petroleum and approved by the Egyptian Council of Ministers and Egypt's Prime Minister.

Under the SPA, UFACEX (later by assignment, UFG) acquired the contractual right to receive from EGPC (later the 100% state-owned Egyptian Natural Gas Holding Company ("EGAS")) a certain supply of natural gas at the Damietta Plant over a period of at least 25 years. The economic feasibility of the Damietta Plant was dependent on receiving the contractually agreed quantities of natural gas from EGPC (later EGAS).

The SPA contains several guarantees including that the "[s]eller shall at all times keep a back up supply [of natural gas] to meet an on stream (load) factor of 95% of the LNG Complex"; that the "[s]eller is the sole responsible [party] for securing adequate supplies of N[atural] G[as] for performance of its obligations"; and that the "[s]eller is aware that the supply of N[atural] G[as] to [the b]uyer under this Agreement is a key element for the successful development of the Project and . . . [the s]eller represents and warrants that its availability of N[atural] G[as] will be sufficient."

Upon executing the SPA, Egypt's Minister of Petroleum committed not to interfere with or adversely affect the rights of UFG even in the case of a domestic natural gas shortage.[3] In reliance upon Egypt's undertaking, UFG spent approximately US$ 1.3 billion to build the Damietta Plant and its associated facilities, completing the project on time and within budget.

From 2006 onward, EGAS failed to deliver the necessary quantities of gas to UFG, and the Egyptian Petroleum Sector prioritized gas for local customers and certain other foreign companies over meeting its commitments to UFG.

On February 14, 2014, the Claimant filed a request for arbitration before ICSID under the BIT.

Jurisdiction and Liability

On August 31, 2018, the Tribunal issued its Award. By majority, it found that it had jurisdiction over the Claimant's claim. The Tribunal found that, while Egypt was not a party to the SPA, "[g]iven the importance of the gas supply for the LNG Project, to be made by EGPC (later EGAS), this undertaking [of non-interference] by the Egyptian authorities was no formality[,]"[4] and therefore the Tribunal rejected the Respondent's defenses of corruption and force majeure.

With respect to the merits, the majority of the Tribunal found that Egypt's actions in the natural gas sector resulted in a shortage of Egyptian gas. The majority concluded that Egypt's decision to prioritize local customers over UFG constituted a breach of the fair and equitable treatment ("FET") provision of the BIT. Egypt's arbitrator appointee, Mark Clodfelter, dissented from these findings.[5]

While the Tribunal took note of the Claimant's arguments under Articles 4(2) and 4(5) of the Treaty, which address discriminatory or "less favourable" treatment, due to the "substantial overlap between these respective protections," the Tribunal focused on the Claimant's case under Article 4(1) of the Treaty (*i.e.*, the FET protection).[6]

In order for the Claimant to successfully demonstrate a breach of the FET provision, the Tribunal determined that the Claimant must establish that: "(i) its expectations were reasonable in the circumstances; (ii) it relied upon such undertaking or representation when it made its investment in Egypt; and (iii) [] the Respondent's non-compliance with its undertaking or representation violated the FET standard in Article 4(1) of the Treaty."[7]

The Tribunal (by majority) concluded that the Respondent's "undertaking" was an important extra-contractual condition for UFACEX's participation in the Project.[8] The Tribunal concluded that the effect of this undertaking was to preclude Egypt, during the 25-year term of the SPA, from:

> (i) interfering with the rights under the SPA of [the Claimant]; (ii) dictating or promulgating any act or regulation which could directly or indirectly affect the rights of [the Claimant] under the SPA; and (iii) affecting the capacity of the Buyer to perform its obligations under the SPA, even in the case of a shortage of natural gas in Egypt – subject to force majeure situations as defined in the SPA.[9]

The Tribunal, by majority, found that it had jurisdiction to hear the Claimant's case[10] and ultimately concluded that Egypt violated the FET standard set forth in Article 4(1) of the BIT.[11]

Quantum

A. Compensation for Breach of the Fair and Equitable Treatment Standard

The Tribunal found that the BIT did not set out a standard of compensation to be applied in the case of any violations of the Treaty except for expropriation, which the Claimant did not allege in this case. As a result, the Tribunal applied the principle of "full reparation" found in customary international law.[12] The Tribunal therefore used a "general approach" to calculating compensation.[13]

B. Damages Claimed by UFG

UFG's primary damages case sought US$ 3.22 billion, composed of UFG's replacement costs, lost profits, and lost dividends in the Spanish-Egyptian Gas Company, S.A.E. ("SEGAS")—the company responsible for operating the Damietta Plant.[14] UFG also provided three alternative damages calculations:

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(i) US$ 2.83 billion, composed of UFG's replacement costs and lost SEGAS dividends;[15] (ii) US$ 2.58 billion, composed of its replacement costs, lost profits, and SEGAS dividends, but deducting all losses suffered by UFG's subsidiary, Unión Fenosa Gas Comercializadora ("UFGC");[16] and (iii) US$ 2.42 billion, composed of UFG's replacement costs and lost SEGAS dividends, but excluding both UFG's damages related to losses that occurred when SEGAS lost its Free Zone status[17] and losses UFGC suffered before June 2013.[18]

In response, Egypt, asserted four principal grounds for rejecting UFG's damages: (i) all damages suffered via UFGC, UFG's subsidiary, should be excluded;[19] (ii) UFG's losses are too speculative;[20] (iii) UFG's entitlement to compensation is limited by the terms of the SPA;[21] and (iv) UFG failed to mitigate its losses.[22]

C. Valuation Methodology

In quantifying the scope of the Claimant's damages, the Tribunal held that it would be an "odd result" if Egypt could be required to pay compensation under the Treaty that was greater than the maximum liability assumed by Seller under the SPA, because Egypt's undertaking "was made in regard to Seller's obligation under the SPA."[23] Therefore, the Tribunal determined the scope of the Seller's possible liability under the SPA. Specifically, the Tribunal looked to Article 8.1(1) of the SPA, which defines the Seller's liability as follows:[24]

> Seller shall be liable to Buyer for any damages, costs and/or expenses (to the extent permissible under Egyptian laws, but excluding consequential damages and loss of profits) arising from Seller's failure to supply, including (i) third party's claims and penalties against Buyer, [and] (ii) costs, extra-costs, damages and expenses caused to the Complex arising from Seller's failure to supply, including operation and maintenance costs (expressed in USD per MMBTU), and capital investment costs (expressed in USD per MMBTU).

Based on the restrictions found within the SPA, the Tribunal rejected UFG's claims for lost profits;[25] lost dividends (in part);[26] revocation of the SEGAS Free Zone status; and non-invoiced payments from UFG's subsidiary, UFGC.[27]

(i) Lost Profits

The Tribunal rejected UFG's claim for lost profits, as Article 8.1 of the SPA expressly excludes lost profits from the scope of compensable damages

(ii) Lost Dividends

The Tribunal concluded that lost dividends were "indirectly consequential" to EGAS' curtailment of feed gas. The Tribunal concluded that these losses were, in principle, compensable as an indirect result of Respondent's undertaking.[28] However, the Tribunal concluded that these losses were caused by two factors: the failure of EGAS to pay fees due to SEGAS, and the nonpayment of dividends by EGAS to the Claimant.

The first category, according to the Tribunal, was outside the scope of Article 8.1, as those losses constituted "consequential damages and lost profits."[29] While the second category was theoretically compensable, the Tribunal concluded that, in light of a related award from the ICC in an arbitration between SEGAS and EGAS, no fees were due to SEGAS under the EGAS Tolling Contract,[30] and, therefore, "no such losses were incurred by the Claimant."[31]

(iii) The Free Zone Claim

The Claimant had alleged that Egypt's revocation of SEGAS' Free Zone status on May 5, 2008, constituted a breach of Egypt's undertaking. The Tribunal concluded that this revocation did not directly target SEGAS, but rather, the "Respondent revoked all Free Zone licenses and tax exemptions for companies in the natural gas industry."[32] As a result, the revocation of this license was found to be neither discriminatory nor a breach of the FET standard in Article 4(1) of the Treaty.[33]

(iv) UFGC Payments

The Tribunal concluded that while "there [was] no doubt that losses sustained by UFGC were passed through and directly suffered as losses by the Claimant[,]" not all of these expenses could qualify as "costs" that were incurred by UFG from third parties as articulated under Article 8.1 of the SPA.[34] Specifically, the Tribunal concluded that in "legal and contractual terms," UFGC "was a stranger, or third party, to the SPA."[35] As a result, only those costs invoiced were compensable.

As a result, the Tribunal accepted UFG's third alternative case on compensation and awarded UFG the principal sum of US$ 2,013,071,000 (after tax, but before interest).[36] This total is composed of UFG's own incremental costs and the costs passed on by UFGC from June 2013 onward.[37]

D. Mitigation

The Tribunal concluded that, to the extent the Claimant had "failed unreasonably to mitigate its losss [sic] in accordance with international law," its damages would be reduced. In so holding, the Tribunal relied on Article 39 of the International Law Commission ("ILC") Articles, which provides:

> In the determination of reparation, account shall be taken of the contribution to the injury[,] by willful or negligent action or omission[,] of the injured State or any person or entity in relation to whom reparation is sought.[38]

The Tribunal held that this test was to be applied "at the relevant time, without the benefit of hindsight" and the burden of proving such unreasonableness rested with the Respondent.[39] Egypt alleged, in particular, that: (i) UFG should have terminated or suspended commitments to downstream buyers including, if necessary, declaring force majeure; and (ii) UFG obtained a "windfall" by purchasing replacement gas from its parent company.[40]

The Tribunal rejected both of these allegations on the basis that (i) UFG's obligation to mitigate its damages did not require it to go out of business and (ii) UFG's replacement purchases were conducted at arm's length "at average prices lower than those available from other unrelated companies."[41]

E. Calculation of Interest

Because the Treaty did not prescribe a specific interest rate, the Tribunal used an interest rate of three-month LIBOR + 2.0%, compounded quarterly.[42] The Tribunal considered this interest rate reasonable for two reasons: (i) it followed the principles in Chorzów Factory (1928); and (ii) it was less than the commercial rate and the rate proscribed in the SPA.[43] The Tribunal considered the SPA's higher interest rate to be inappropriate because Egypt is not a commercial party and is liable under the Treaty, not the SPA. The Tribunal adopted compound interest, keeping in mind the awards in *Compañia del Desarrollo v. Costa Rica* (2000) and *Gemplus v. Mexico* (2000).[44]

This interest rate applied to pre-award interest commencing on January 1, 2016, as well as post-award interest from the date of the Award until the date of payment.

The Tribunal also took note of the fact that UFG was pursuing compensation for its losses in a concurrent, pending contract arbitration against EGAS under the Cairo Regional Center for Commercial Arbitration rules. As a result, the Tribunal requested, and UFG accepted, a commitment that UFG will not seek "double-recovery."[45]

1 A redacted version of the Award dated August 31, 2018, *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4 (hereinafter "Award") is available via D.C. District Court filing under Case 1:18-cv-02395.

2 King & Spalding represented Claimant.

3 Award, ¶ 9.145.

4 Award, ¶ 5.66.

5 Because Mark Clodfelter's dissent was on the basis of jurisdiction, it is not discussed in detail in this case comment.

6 Award, ¶ 9.5.

7 Award, ¶ 9.53.

8 Award, ¶ 9.64

9 Award, ¶ 9.71.

10 Award, ¶ 7.117.

11 Award, ¶ 10.94.

12 Award, ¶ 10.96 (referring to this "long established" principle from the PCIJ's judgment in Chorsów Factory (1928) and confirmed by Articles 31 and 36 of ILC Articles on State Responsibility).

13 Award, ¶ 10.101.

14 Award, ¶ 10.2.

15 Award, ¶ 10.10.

16 Award, ¶ 10.11.

17 UFG's allegation regarding SEGAS' Free Zone status relates to UFG's allegation that Egyptian Law No. 114, eliminating Free Zone licenses and subjecting SEGAS to Egyptian taxes, constituted a breach of the FET standard of the BIT.

18 Award, ¶ 10.12.

19 Award, ¶ 10.62.

20 Award, ¶ 10.75.

21 Award, ¶ 10.82.

22 Award, ¶ 10.88.

23 Award, ¶ 10.105.

24 The Tribunal also took note of the SPA's liability cap; however, it concluded that the liability cap was greater than the liability calculated by UFG's experts and therefore not relevant to the assessment of the Claimant's damages. Award, ¶ 10.109.

25 Award, ¶ 10.111.

26 Award, ¶ 10.112.

27 Award, ¶¶ 10.120-10.122.

28 Award, ¶ 9.147.

29 Award, ¶ 10.113.

30 Under the EGAS Tolling Contract, EGAS would provide feed gas for the plant to SEGAS and, if not gas was provided, EGAS would pay SEGAS a fee.

31 Award, ¶ 10.115.

32 Award, ¶ 9.150.

33 Award, ¶ 9.153.

34 Award, ¶ 10.121.

35 Award, ¶ 10.117.

36 Award, ¶ 10.133; with the caveat that the Tribunal reduced UFG's damages expert's calculations by US$ 220 million to reflect UFG's lesser need for working capital and taxes, Award, ¶ 10.9.

37 Award, ¶ 10.134.

38 Award, ¶ 10.125.

39 Award, ¶ 10.126.

40 Award, ¶¶ 10.127, 10.131.

41 Award, ¶¶ 10.130-10.131.

42 Award, ¶ 10.138.

43 Award, ¶ 10.138.

44 Award, ¶ 10.139.

45 Award, ¶ 10.142.

Recent Damages Awards

Vantage Deepwater Company and Vantage Deepwater Drilling, Inc. v. Petrobras America Inc., Petrobras Venezuela Investments & Services, BV, Petróleo Brasileiro S.A. (Petrobras Brazil), ICDR Case No. 01-15-0004-8503

Date of the Award
June 29, 2018

Decision on Annulment
Pending

The Parties
Vantage Deepwater Company ("Vantage Deepwater") and Vantage Deepwater Drilling, Inc. ("Vantage Deepwater Drilling") (jointly, "Claimants"), Petrobras America Inc. ("Petrobras America"), Petrobras Venezuela Investments & Services, BV ("Petrobras Venezuela"), and Petróleo Brasileiro S.A. ("Petrobras Brazil") (jointly, "Respondents")

Sector
Oil & Gas

Members of the Tribunal
William W. Park (president), Charles N. Brower (Claimants' appointee), and James M. Gaitis (Respondents' appointee)

Background

The dispute concerned the alleged early termination of the Drilling Services Agreement ("DSA")[1] signed by the Parties in 2009—which had then been novated and amended several times. The DSA related to an oil drilling rig, or deepwater drilling ship, leased by Claimants to Respondents for an eight-year period. The equipment was delivered in December 2012, so the lease period was expected to end in December 2020.

Claimants contended that Respondents terminated the DSA early—only two years and nine months into the eight-year term—and refused to pay the day rate due for the remaining term, to cut costs after the deterioration of market conditions.

Respondents denied liability and sought damages through multiple counterclaims, mostly related to the alleged fraudulent inducement of the DSA, which Respondents claimed provided them with grounds to terminate it.

In 2018, the Tribunal, by a majority decision ("Majority"), dismissed Respondents' counterclaims with prejudice, awarding Claimants damages for the early breach of the DSA.[2] The dissenting arbitrator argued, in essence, that Respondents had their "fundamental fairness and due process protections" denied.[3]

Jurisdiction and Liability

Claimants contended that jurisdiction existed over all named parties. Respondents, on the other hand, argued that Petrobras America and Vantage Deepwater Drilling were the only proper parties.

The Tribunal decided that jurisdiction existed over all five named parties, finding that the dispute fell within the arbitration clause of the Third Novation, signed by Petrobras Venezuela. Likewise, Vantage Deepwater and Petrobras Brazil were proper parties as signatories to the Guaranty.[4]

On the merits, Claimants asserted that Respondents materially breached the DSA—as amended and novated—for convenience due to

deteriorating market conditions, and failed to negotiate in good faith.[5] Respondents, on the other hand, alleged they properly terminated the DSA for operational reasons. Regarding Claimants' proposed cure of Respondents' alleged default, Respondents claimed it was insufficient and ineffective, and therefore properly rejected.[6] The Majority found that Respondents committed a material breach under the DSA through early termination and refusal without justification to pay the day rate due for the remainder of the DSA's term. The Majority held that Respondents failed to demonstrate that Claimants did not implement or propose cures, after Claimants were provided proper notice following the alleged material breaches.

On the issues of bribery and corruption, Claimants argued that the DSA was a valid contract, and that Respondents not only failed to establish Claimants' knowledge of bribery but also that any illicit payments were paid to induce the DSA. Claimants also alleged that Respondents failed to establish their own unawareness of any illicit payments, and actually continued to perform—knowingly ratifying the DSA—after having sufficient knowledge of the alleged scheme, thus waiving any right to avoid it on the basis of bribery.[7] Respondents, on the other hand, claimed that Claimants fraudulently induced the DSA's formation and continuation.[8]

The Majority concluded that subsequent novations and amendments formed new contracts, untainted by bribery (if any had existed), and so by knowingly ratifying the DSA in its current form, Respondents were now estopped from claiming it was void or voidable.

Limitation-of-Liability Clause of the DSA

As a result of Respondents' material breach of the DSA, Claimants demanded recovery of direct, benefit-of-the-bargain losses arising out of the DSA. Claimants' argument was focused on the lack of the word "direct" in the text of the clause, thereby imposing no limit on either party's potential liability for consequential damages.[9] Claimants asserted that:

> The law recognizes that "[l]ost profits may be classified as either direct or consequential damages, depending on their nature.... [P]rofits on the contract itself—such as the amount a party would have received on the contract minus its saved expenses—are direct damages." As the result, courts routinely construe clauses like Clause 19.9 as permitting recovery of lost profits as direct damages.[10]

Conversely, Respondents argued that the DSA prevented Claimants from recovering any damages, either direct or indirect, relying on the "however same may be caused" language at the end of the clause.[11] According to Respondents, the language of the DSA would be rendered meaningless under Claimants' construction, as it would not explain why the listed losses were defined collectively under the term "Consequential Damages" in the last part of the sentence. Besides, Respondents argued, Claimants' interpretation would violate the governing law chosen by the parties—English law.

The Majority found that Claimants were correct in their interpretation. The DSA must be read in accordance with its plain meaning, and the lack of the word "direct" plays a significant role in permitting recovery of Claimants' direct, benefit-of-the-bargain damages. According to the Majority, "Anglo-American contract law constitutes the core of damages aimed at compensation for a breach."[12] Regarding Respondents' argument, the Majority found that the qualification of the damages must be read in the context of the entire clause, such that direct damages would not be excluded under the "however same may be caused" provision, which relates only to consequential damages. According to the Majority:

> [T]he main elements of the Clause might be diagrammed as follows:
>
> (a) no liability for consequential damages;
>
> (b) amplification [of] that exclusion of consequential damages applies regardless of their basis, whether contract, warranty, or tort;
>
> (c) further amplification [of] that exclusion of consequential damages applies regardless of whether related to loss of revenue or loss of profits.[13]

In short, the benefit-of-the-bargain damages claimed by Claimants did not fall into any of the categories provided in the DSA. The Majority further held that the clause, as written, prevents a party from transforming the excluded damages—consequential damages—into some other category by simply saying that the damages include items such as production or profits. The Majority said it took into consideration the argument that "loss of production" and "loss of revenue" arise from direct failure of performance, making those categories into "direct" damages, but added that in some instances, lost revenue or lost production might be indirect damages, and so excludable in this case.[14]

The Majority denied Respondents' argument that Claimants' interpretation of the clause would render the DSA illusory. Rather, as the contract relates to production, Claimants "would hardly ever be able to recover for any damages, no matter how egregious Respondents' behavior was since the argument could always be made that recovery related in some way to production."[15]

Damages Analysis

A. Claimants' Benefit-of-the-Bargain Damages

Claimants and Respondents agreed that benefit-of-the-bargain damages should be calculated by taking what the non-breaching party would have received if the contract had not been breached, minus subcontracting costs that the non-breaching party avoided by not having to perform, then deducting from the final sum any amounts the non-breaching party would have earned after the breach through mitigation.[16] The parties nonetheless differed in the amount that should be awarded.

To quantify their benefit-of-the-bargain damages, Claimants considered the payments received and costs incurred in an eight-month period before the breach—January through August 2015—suggesting that this amounts would serve as a "reasonable proxy" of the amounts Claimants would have received and the costs they would have incurred during the remainder of the DSA's term but for the contract breach and termination.[17] Claimants then compared the "but-for" numbers to their actual and projected revenue and costs due to the DSA's termination, including mitigation, arriving at a final figure discounted to the date of the breach using their Weighted Average Cost of Capital ("WACC").[18]

Respondents raised objections to Claimants' damages claims and assumptions. One of the objections was that Claimants were seeking damages "for the entire family of Vantage entities," not only and specifically for the two Claimants in the arbitration. Respondents asserted that this both was improper and invited the Tribunal to exceed its authority.[19] Further, Respondents argued that Claimants were ignoring the impact of Vantage's bankruptcy in their but-for scenario, thus overstating their damages.[20]

The Majority rejected Respondents' argument that awarding damages to Claimants was the same as awarding damages to the entire family of Vantage entities. The Majority found that both Vantage Deepwater and Vantage Deepwater Drilling were, or at least had been, parties to the DSA, so there was no excess of authority in assessing their damages.

The Majority further held that, "although as an economic matter profits from the DSA might be allocated to other entities in the Vantage group, the damages themselves stem directly from the day rates under the DSA and the actual costs that Claimants incurred."[21] Accordingly, the benefit-of-the-bargain damages Claimants sought were their own damages, not those of third parties.

The Majority also rejected Respondents' argument that the reduced debt payments of Vantage's parent company due to bankruptcy should be considered as costs avoided by not having performed the DSA. According to the Majority, "as a matter of policy, the Tribunal considers it would be inappropriate for Respondents to derive a benefit from Vantage's economic losses due to the bankruptcy."[22] Specifically, the Majority concluded that it does not make sense that an enterprise's bankruptcy could enable another party to avoid paying for harm it caused to the bankrupt enterprise.[23]

Lastly, the Majority found that Respondents did not meet their burden of proving that Claimants had failed to try to mitigate their damages. On the contrary, the Majority found that Claimants had actively tried to mitigate.[24]

B. Respondents' Counterclaims

Respondents made counterclaims seeking disgorgement of Vantage's alleged ill-gotten profits and prevention of unjust enrichment through a constructive trust.[25] Respondents stated that if the Tribunal were to find that Claimants would have earned any profits under the DSA, those should be awarded to Petrobras America and Petrobras Venezuela as damages. The counterclaims depended mainly on the assumption that Vantage or its affiliates, personnel, or agents committed, or at least benefited from, acts of bribery or corruption to procure the DSA.

The Majority denied all of Respondents' counterclaims as unproven. Further, Respondents had ratified the DSA, and by reason of their own subsequent conduct, could not raise the counterclaims.[26] The Majority held that Respondents did not provide any breakdown of damages with respect to individual counterclaims, so "it appears Respondents may intend that the quantum would be the same whether the Tribunal grants all, some, or even just one of the counterclaims."[27]

As for Respondents' assertion that they had the right to receive exemplary damages on the basis that the DSA does not preclude them, Claimants argued that Respondents had not proved a basis for exemplary damages, had received the full value for which they were entitled under the DSA, and had not specified any loss.[28] Finally, Claimants noted that Clause 19.9 of the DSA precluded Respondents' claim for exemplary damages.

Again, the Majority found that Respondents had not proved that Claimants were liable, either directly or by imputation, for acts of bribery or corruption, and had not identified the exemplary damages that they requested. Respondents' exemplary damages request was thus also denied.

C. Interest

The Third Novation of the DSA authorized the Tribunal to grant pre- or post-award interest at applicable statutory interest rates during the relevant period. The Majority found this provision to be in consonance with the AAA Commercial Arbitration Rules—the rules applicable to the case—which allow "interest at such rate and from such date as the arbitrator(s) may deem appropriate."[29] Nonetheless, none of the parties had put forth a statutory rate, so the Majority decided from among the rates the parties had proposed.

The Majority concluded that pre- and post-award interest should also be compounded monthly and not as a "risk-free rate"—as suggested by the Respondents' expert—as this would not suffice to make Claimants whole.[30] Instead, the Majority chose the rate of 15.2% proposed by the Claimants' expert, Dr. Jacobs, the same WACC rate he used to discount damages up to the date of the breach.[31]

D. Bareboat Charter Mechanism

Claimants utilized a Bareboat Charter in their acquisition and use of the Titanium Explorer, to minimize taxes. Claimants asserted that the Bareboat Charter was part of Vantage's capital structure, which "merely apportions the gains and losses of entities such as Vantage," under common ownership and control.[32]

Respondents criticized Claimants' damages calculation for its lack of consideration of this charter, and for not reducing damages to account for Claimants' transfer of DSA profits to affiliates within the consolidated Vantage group of companies through the charter arrangement. Respondents' argument was that the lack of accounting for costs under this mechanism meant that Claimants' damages were overstated if they existed at all.[33]

The Majority asserted that there was no evidence that the Bareboat Charter tax structure, common in the offshore drilling industry, should alter damages. According to the Majority, "as a matter of logic, loss to Claimants caused by the DSA termination occurred before calculation of payments under the Bareboat Charter," so Claimants were correct in excluding the charter from their damages.[34] The Majority noted that the DSA itself mandated the use of such a structure when it required Claimants to use "reasonable endeavors to minimize Taxes with respect to this Contract".[35]

Fees and Costs

Respondents argued that Claimants must pay all their costs because Claimants had breached the DSA by commencing the arbitration without first holding "direct negotiations in good faith" to resolve the dispute. Claimants called attention to the DSA's wording providing that "all arbitration fees and costs shall be borne equally regardless of which Party prevails. Each Party shall bear its own costs of legal representation and witness expenses."[36] Claimants argued that this express provision precluded any award of attorneys' fees and costs.

As for attorneys' fees, the Majority noted that the presumption that each side bears its own legal expenses has long been established within the United States, and that neither side had provided any reason to overturn that presumption in this case.[37]

Regarding the costs of arbitration, the Majority found that the DSA precluded any allocation other than an equal share among the parties and that the AAA Commercial Arbitration Rules reinforced this position.[38] The Majority thus determined that the parties should bear the arbitration costs equally.

Dissent

The dissenting arbitrator indicated an intention not to sign the Award, and submitted a dissent arguing that Respondents had their "fundamental fairness and due process protections" denied.[39]

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[1] *All capitalized terms that are not defined herein have the meanings given to them in the Vantage Deepwater Company et al. v. Petrobras America Inc. et al.,* ICDR Case No. 01-15-0004-8503, Award, June 29, 2018 ("Award").

[2] Award.

[3] *Vantage Deepwater Company et al. v. Petrobras America Inc. et al.,* ICDR Case No. 01-15-0004-8503, Dissenting Opinion of J. Gaitis, June 28, 2018.

4 Award, ¶ 202 ("The language of the Guaranty is plain. The Tribunal must consider the Guaranty's direction to look at the DSA for a dispute resolution process. The DSA mentions the possibility of amendments and novations. Indeed, the DSA (including its arbitration clause) was amended and novated.").

5 Award, ¶ 212.

6 Award, ¶ 230.

7 Claimants cited Restatement (Third) Agency § 4.01 and § 4.06 & cmt. D; *Standard Oil Co. of Tex v. Manley,* 178 F.2d 136, 138 (5th Cir. 1949); *City of Findlay v. Pertz*, 66 F 427.

8 Award, ¶ 272 ("Respondents claim there is 'overwhelming evidence' that the DSA was procured through bribery, which taints the Contracts and renders it unenforceable, as well as void, voidable, and unconscionable").

9 Citing DSA, Clause 19.9 ("Neither COMPANY on one hand, nor the CONTRACTOR on the other hand (nor its respective Affiliates) shall be liable to the other party for any indirect, incidental, special, punitive, consequential or Exemplary Damages, whether any claim for such losses or damages is based on contract, warranty, tort (…), strict liability or otherwise (…), or other fault of any of the other Party the unseaworthiness of any vessel of craft, or a pre-existing condition, including, without limitation, loss of revenue, loss of profits, loss of production, business interruptions, use of capital, reservoir loss or damage, however same may be caused (collectively "Consequential Damages").").

10 Claimants' Post-Hearing Brief ¶ 415 (quoting *Cherokee County Cogeneration Partners, L.P. v. Dynegy Mktg. & Trade,* 305 S.W. 3d 309, 314 (Tex. App.—Houston [14th Dist.] 2009, no pet.)).

11 Citing DSA, Clause 19.9.

12 Award, ¶ 313.

13 Award, ¶ 316.

14 Award, ¶ 321.

15 Award, ¶ 322.

16 Award, ¶ 440

17 Award, ¶ 441.

18 Award, ¶ 442-443.

19 Award, ¶ 446.

20 Award, ¶ 449. (Respondents argued that the Claimants' expert "failed to account for the fact that Vantage's bankruptcy allowed Vantage to lower and delay payment on its debt, thus reducing its costs.").

21 Award, ¶ 454.

22 Award, ¶ 457.

23 Award, ¶ 457 (B) ("Accordingly, the Tribunal concurs with Dr. Jacobs' [Claimants' expert] position that it does not make sense that 'bankruptcy enables you to avoid paying for the harm you cause the enterprise.'").

24 Award, ¶ 457 (C) ("On the contrary, evidence shows that Vantage sought to redeploy the Titanium Explorer, participating in three tenders, albeit unsuccessfully, since August 2015.").

25 Award, ¶ 339 ("The Second Respondent and the Third Respondent make counterclaims totaling US$ 101,829,302.00 based on Vantage's alleged misconduct, including fraud, bribery, aiding and abetting of alleged breaches of fiduciary duties by Messrs. Zelada and Musa, negligent misrepresentation, civil RICO violations, and 'money had and received.'").

26 Award, ¶ 433.

27 Award, ¶ 344.

28 Award, ¶ 429.

29 Citing AAA Commercial Arbitration Rules at R-47(d)(i).

30 Award, ¶ 463.

31 Award, ¶ 463-464.

32 Award, ¶ 480 (Claimants emphasize that the Bareboat mechanism is utilized by virtually every other contractor in the offshore drilling business, and that if Respondents' argument were accepted, virtually every company in the offshore drilling industry would be deprived of meaningful recovery in breach of contract cases.).

33 Award, ¶ 478-480 (Claimants emphasize that the Bareboat mechanism is utilized by virtually every other contractor in the offshore drilling business, and that if Respondents' argument were accepted, virtually every company in the offshore drilling industry would be deprived of meaningful recovery in breach of contract cases.).

34 Award, ¶¶ 488-489

35 Citing DSA, Clause 18.1.1.

36 Award, ¶ 10.133; with the caveat that the Tribunal reduced UFG's damages expert's calculations by US$ 220 million to reflect UFG's lesser need for working capital and taxes, Award, ¶ 10.9.

37 Award, ¶ 517.

38 Citing AAA Commercial Arbitration Rules at R-54.

39 Dissenting Opinion of J. Gaitis, June 28, 2018.

UP and C.D. Holding Internationale v. Hungary, ICSID Case No. ARB/13/35

Date of the Award
October 9, 2018 ("Award")

The Parties
UP (formerly Le Chèque Déjeuner) and C.D. Holding Internationale ("C.D. Holding" and, jointly with UP, the "Claimants"), Hungary (or the "Respondent")

Sector
Accommodation and Food Service Activities

Applicable Treaty
Bilateral Investment Treaty between France and Hungary (the "BIT")

Members of the Tribunal
Prof. Dr. Karl-Heinz Böckstiegel (president), the Honorable L. Yves Fortier PC CC OQ QC (Claimants' appointee), and Sir Daniel Bethlehem KCMG QC (Respondent's appointee)

Background

UP is a cooperative company, and C.D. Holding is UP's wholly owned subsidiary. In late 1995, Claimants entered the Hungarian market through their wholly owned subsidiary Le Chèque Déjeuner Kft ("CD Hungary"). CD Hungary was a fringe voucher issuer: it sold vouchers to employers, who granted them to employees as part of their compensation. The employees were entitled to use the vouchers at various affiliates to purchase goods and services. CD Hungary was primarily active in the food voucher business, including both "cold food" vouchers for use at supermarkets and grocery stores, and "hot food" vouchers for use at restaurants. It marginally issued gift vouchers as well as school-supplies vouchers.

In 1999 and 2000, Hungary passed two tax reforms. First, the tax rate applicable to cold-food vouchers and gift vouchers was substantially increased, prompting CD Hungary to focus on hot-food vouchers only. Later, the tax rates applicable to hot- and cold-food vouchers were realigned, prompting CD Hungary to create a new type of voucher that could be redeemed for both kinds of food.

In 2011, Hungary passed a reform that amended the regulations applicable to fringe vouchers. First, Hungary created SZÉP cards, a dematerialized alternative to paper vouchers, which could be used for various goods, including "hot food." Claimants did not meet the legal conditions required to issue SZÉP cards. Second, Hungary created Erzsébet vouchers, which could be used to pay for cold food (and eventually also hot food).

Claimants argued that because only the SZÉP cards and Erzsébet vouchers (and not the vouchers issued by Claimants) benefited from lower tax rates, Claimants' vouchers were unattractive to employers. CD Hungary's market share and revenues fell, and it had to cease its operations in 2013.

In December 2013, Claimants filed a request for arbitration before ICSID under the BIT, claiming that Hungary's reforms resulted in the expropriation of their investment and that Hungary breached its obligation to treat their investment fairly and equitably (the "FET claim").

Jurisdiction and Liability

On March 3, 2016, the Tribunal issued its Decision on Preliminary Issues of Jurisdiction ("Decision on Jurisdiction"). It found that it had jurisdiction over all claims raised.[1] In its Award, the Tribunal found that the March 6, 2018, *Achmea* decision[2] did not affect its Decision on Jurisdiction: (1) unlike in the *Achmea* case, the Tribunal's jurisdiction is based on the ICSID Convention and therefore the Tribunal is placed in a public international law context and not in a national or regional context; (2) Hungary's membership in

the European Union ("EU") is irrelevant—Hungary is a party to the ICSID Convention and therefore is expressly bound by the Award, has no appeal outside the ICSID system, and has to enforce the Award as if it were a final judgment of a court in Hungary; (3) even if the BIT were deemed retroactively terminated when Hungary acceded to the EU, the survival clause in the BIT kept the BIT's arbitration agreement in force for an additional 20 years.[3]

On the merits, the Tribunal determined that from the text of Article 5(2) of the BIT, the test for expropriation is whether any "measures" together (as opposed to any measure by itself) had the effect of dispossession. To determine whether there is a dispossession, the Tribunal has to compare the economic value of Claimants' investment before and after the measures. The Tribunal found that the package of Hungary's measures in the 2011 reform resulted in the creation of a state monopoly (through the SZÉP cards and Erzsébet vouchers) that excluded CD Hungary from the meal-voucher market, and therefore dispossessed Claimants of the greatest part and the economic heart of their investment (by destroying CD Hungary's economic value).

The Tribunal next examined whether the expropriation was lawful. Although it concluded that the expropriation was unlawful for the reason that Hungary did not offer or pay any compensation after the 2011 reform alone, having considered the parties' discussions, the Tribunal also determined that the expropriation was unlawful on the basis that (1) the legislation's ostensible public purpose of keeping profits within the country is not a legitimate public purpose; (2) Hungary's deliberate targeting of Claimants' investment cannot be a legitimate exercise of a state's police powers; and (3) the 2011 reform was discriminatory, as it was intended to and in fact did exclude CD Hungary and other foreign investors from the market.[4]

As for Claimants' FET claim, the Tribunal noted that the parties did not submit different requests as resulting from a possible breach of Article 5(2) versus Article 3 of the BIT. The Tribunal thus concluded that it need not examine whether Hungary would be liable for a breach of Article 3 of the BIT, because if it were to find that Hungary also breached Article 3 of the BIT in addition to Article 5(2) of the BIT, it would not lead to more damages than those resulting from the breach of Article 5(2).[5]

Quantum

A. Compensation for Expropriation

The Tribunal agreed with Claimants that the compensation rule for expropriation as provided in Article 5(2) of the BIT (entitling Claimants to nothing more than the actual value of their investment) is an express *lex specialis* for lawful expropriation. The Tribunal recognized that most legal systems, though by different terminology and criteria, distinguish between liability for *"compensation"* for lawful measures and liability for *"damages"* resulting from unlawful measures. The Tribunal followed investment jurisprudence (including *ADC v. Hungary*) in concluding that the compensation standard in the BIT will apply only to lawful expropriation, with damages for unlawful expropriation—as in this case—being governed by customary international law, which prescribes full reparation to wipe out the consequences of the unlawful act (including reparation for consequential damages).[6]

The parties agreed that damages may be assessed using the discounted cash flow ("DCF") method if the Tribunal found a breach of the BIT and did not apply the compensation standard in Article 5(2) of the BIT for lawful measures, but they disagreed as to how that method should be applied in this case.[7] The parties also accepted January 1, 2012, as the valuation date. The Tribunal found the destruction of the value of Claimants' shareholding to be permanent at that point in time and accepted Claimants' decision to withdraw from the market in 2013, finding that this decision rendered the costs associated with that withdrawal compensable.[8]

(i) Valuation Methodology

1. The Tribunal applied a "but-for" valuation

The Tribunal discussed the parties' experts' application of the DCF method in detail and recalled its conclusion that Hungary intentionally created a state monopoly and evicted CD Hungary from the meal-voucher market (or, at the very least, knew that the effect of the 2011 reform would be that no clients would continue to buy CD Hungary's meal vouchers, instead buying the SZÉP card and Erzsébet voucher). The Tribunal determined that the but-for calculation (*i.e.*, without the introduction of the 2011 reform) must start from that basis to evaluate the damage Claimants suffered compared to the value of their investment had Hungary not established such a state monopoly.[9]

The Tribunal agreed with the parties' experts that a five-year projection period (from 2012 through 2016) for CD Hungary's cash flows was appropriate, considering CD Hungary's trading history, the relative maturity of the Hungarian market, and CD Hungary's rates of growth in the years until 2011. The Tribunal concluded that after 2016, CD Hungary would have only attained growth in line with the long-term rate of inflation in Hungary.

The Tribunal also accepted the parties' experts' agreed choice of discount rate, which was CD Hungary's weighted average cost of capital ("WACC"), although the experts disagreed on what the correct WACC should be.

2. Factors relevant to the but-for valuation

The parties' experts disagreed on a number of areas regarding the but-for valuation of CD Hungary. These were:

- Hungary's economic outlook;
- CD Hungary's exposure to legislative risks;
- the market risk from the reforms of 2009 and 2010;
- the impact of the SZÉP card and Erzsébet voucher's entry on the playing field; and
- the effect of transition to electronic cards (dematerialization).

The Tribunal expressed that it would not make a simplistic binary choice between the two different positions of the parties' experts; rather, it would, as the Permanent Court of International Justice ("PCIJ") did in *Chorzów Factory*, refer to the different valuations presented by the parties and their experts and base its conclusions on the valuations, facts, and documents submitted to it.[10]

a. Hungary's economic outlook

The Tribunal accepted Claimants' expert's views that the assumptions that inform the DCF projections in a fair market value analysis must be based on information that would have been known to a hypothetical buyer as of the valuation date and, therefore, growth in the Hungarian voucher market should be forecasted in accordance with the expected wage growth in Hungary as of the valuation date. The relevant macroeconomic factors that indicate growth in revenues for the voucher market are: (1) employment growth; (2) higher minimum wages; and (3) higher inflation, which increases interest rates, thereby increasing financial revenues earned from the cash float. The Tribunal was persuaded by Claimants' expert's views that Hungary's economic outlook was positive as of the valuation date.[11]

b. CD Hungary's exposure to legislative risk

The Tribunal found that although legislative risks existed for Claimants from the very beginning of their investment (in light of Hungary's yearly updates of the relevant legislation), the 2011 reform was different, as it was a series of measures that created a state monopoly that was not foreseeable by Claimants and in fact dispossessed them of their investment.[12]

c. The market risks from the reforms of 2009 and 2010

The Tribunal agreed with Claimants' expert and found that CD Hungary's lobbying skills (that is, its ability to influence legislation) and its ability to adapt to legislative changes would mitigate legislative risk, as shown in its past performance. The Tribunal therefore rejected as inappropriate Hungary's expert's recommendation to add an additional legislative risk premium of 1.5% to the WACC, preferring instead Claimants' expert's use of a 12.8% WACC.[13]

d. The impact of the SZÉP card and Erzsébet voucher's entry on the playing field

The Tribunal did not accept Hungary's expert's assumption that CD Hungary's market share would gradually decline over the projection period as a result of SZÉP card issuers' having established themselves in the hot-meal voucher market and then taken market share from the incumbent issuers. This is because the Tribunal found the introduction of the SZÉP card to be among the measures included in the Treaty breach.[14]

e. The effect of transition to electronic cards (dematerialization)

The Tribunal determined that a potential buyer would have taken the transition to electronic vouchers into account because dematerialization would result in a reduction in revenues from lost or expired vouchers. The Tribunal rejected Hungary's expert's view that dematerialization would have begun on the valuation date, because dematerialization was not imminent as of January 1, 2012, and the documentary record confirmed that Hungary was not prepared for dematerialization as of that date.[15]

3. Debt for the WACC calculation can be based on debt at the parent company level

Hungary's expert did not disagree with Claimants' expert that debt should be included in the WACC, but argued that Claimants' expert's calculation of CD Hungary's WACC was understated. Hungary's expert pointed out that Claimants' expert applied a rating of AA, meaning that it equated CD Hungary's credit rating to that of large, multinational, diversified parent companies. Claimants' expert explained that CD Hungary is a wholly owned subsidiary of Claimants, with debt held at the parent-company level. The Tribunal did not find it unreasonable to calculate CD Hungary's debt based on debt held at the parent company level, given that CD Hungary's parent company in France is a large multinational company.[16]

4. Terminal value should be calculated

The Tribunal agreed with Claimants' expert that it is standard practice to include a terminal value (*i.e.*, value of lost cash flows beyond the projection period) in the net present value of the cash flows in the projection period:

Respondent dispossessed Claimants of an investment with long-term income generating prospects, and the proper compensation to be awarded is its fair market value as of the Valuation Date. At the time of dispossession, there was no prospect that after a certain period, Hungary would annul the legislative measures in breach of the BIT, as it now has. The BIT provides that the fair market value must be established as of the Valuation Date, with the information a prospective buyer would have had at that time. There is, thus, no reason to deduct the terminal value in CD Hungary's DCF model.[17]

Although the Tribunal believed Claimants had met their burden of proof in establishing the terminal value, the Tribunal rejected Claimants' late amendment to the terminal value, as it was only introduced by their expert in his oral testimony and then by Claimants only in their post-hearing brief (and there was no second round of post-hearing briefs). Claimants also were not found to have provided sufficient evidence demonstrating what was changed or how, as only the results of the new calculation were provided.

B. Losses Associated with Výroba

The parties were in agreement that Výroba is a third company located and incorporated in the Czech Republic, and that it supplied Claimants' paper vouchers. Claimants argued that it ought to recover lost profits suffered by Výroba, which one of the Claimants (C.D. Holding) purported to own indirectly through various different subsidiaries that were not parties to or part of the relevant investments.

The Tribunal shared the view expressed in Gemplus and other cases that the payment of damages

resulting from a breach of a treaty serves to compensate an investor for *"losses it has actually suffered – not for losses suffered by third parties over which the tribunal has no jurisdiction."* The Tribunal noted the BIT's definition of *"investment"* as assets established *"in accordance with the legislation of the Contracting Party in whose territory or maritime zones the investment was made."* The Tribunal concluded that Výroba was neither an "investor" nor a protected investment under the BIT, and also referred in support of its conclusion to the prevailing case law and the reasoning of several tribunals that had dealt with similar scenarios.[18]

C. Standard of Compensation for Breach of Fair and Equitable Treatment

The Tribunal considered it unnecessary to consider the standard of compensation for a violation of the obligation under Article 3 of the BIT to afford fair and equitable treatment, given its decision that it need not find whether Hungary would be liable for a breach of Article 3 of the BIT.

Interest and Costs

The Tribunal rejected Hungary's position that it should limit interest to a calculation of the *"taux de marché approprié"* in Article 5(2) of the BIT, given

its conclusion that Hungary's measures were not a lawful, but were rather an unlawful, dispossession. The Tribunal held that guidance should be taken from the principle of *restitution ad integrum* under international law as reflected in Article 38 of the ILC Articles and that, as stated by the tribunal in *Siemens v. Argentina,* the appropriate rate of interest should take into account *"the interest rate the amount of compensation would have earned had it been paid after the expropriation,"* in order to give effect to the principle of full reparation.

The Tribunal did, however, consider it appropriate to be guided by Article 5(2) of the BIT, which provides for the *"applicable market rate."*

Considering Respondent's breach of Article 5.2 of the BIT and that its measures were an unlawful dispossession, the Tribunal agreed with Claimants that interest could not be limited to a calculation of *"taux de marché approprié";* rather, the appropriate rate should be guided by the principle of *restitution ad integrum* under international law. Referring to *Siemens v. Argentina,* the Tribunal considered that to give effect to the principle of full reparation, it should take into account "the interest rate the amount of compensation would have earned had it been paid after the expropriation." The Tribunal agreed with Claimants that EURIBOR plus 6.01% was appropriate, and followed the standard practice in recent investment arbitration by ordering that the interest shall accrue annually and be compounded annually until the date of payment.

The Tribunal awarded costs based on the relative success of the parties on each question (jurisdiction, liability, and quantum). The Tribunal found that Hungary had failed in its objection to jurisdiction, and while it did not doubt that Hungary had made its objections to jurisdiction in good faith, this did not change the fact that it failed with those objections, and particularly that the bifurcation of jurisdiction had caused a considerable delay and increased the total costs of the arbitration. The Tribunal also found Hungary to have failed on the question of liability, but partially to have prevailed on quantum. It therefore ordered Hungary to pay Claimants 75% of the costs reasonably claimed by Claimants, and for Hungary to bear its own costs of arbitration.

1 Decision on Preliminary Issues of Jurisdiction ¶ 228.
2 *Slovak Republic v. Achmea* (Case-284-16) CJEU (March 6, 2018), (*"Achmea* Decision"),.
3 Award, ¶ 265.
4 Award, ¶¶ 354, 411-417.
5 Award, ¶ 493.
6 Award, ¶ 512.
7 Award, ¶ 519.
8 Award, ¶ 560.
9 Award, ¶ 562.
10 Award, ¶ 566.
11 Award, ¶ 568.
12 Award, ¶ 569.
13 Award, ¶ 570.
14 Award, ¶ 571.
15 Award, ¶ 572.
16 Award, ¶ 579.
17 Award, ¶ 582.
18 Award, ¶¶ 577-588.

Recent Damages Awards

Phillips Petroleum Company Venezuela Limited, ConocoPhillips Petrozuata B.V. v. Petroleos de Venezuela, S.A., Corpoguanipa, S.A., PDVSA Petroleo, S.A., ICC Case No. 20549/ASM/JPA (C-20550/ASM)

Date of the Award
April 24, 2018

The Parties
Phillips Petroleum Company Venezuela Limited ("CPH"), ConocoPhillips Petrozuata B.V. ("CPZ") (collectively, the "Claimants"); Petroleos de Venezuela, S.A. ("PDVSA"), Corpoguanipa, S.A. ("Corpoguanipa"), PDVSA Petroleo, S.A. ("PDVSA Petroleo") (collectively, the "Respondents")

Sector
Oil & Gas

Members of the Tribunal
Dr. Laurent Lévy (president), Prof. Laurent Aynès (Claimants' appointee), and Prof. Andrea Giardina (Respondents' appointee)

Background

In the face of declining oil production, Venezuela invited foreign oil companies to enter into joint ventures for developing extra-heavy crude oil ("EHCO") reserves in Venezuela in the 1990s. To make investment more commercially attractive, Venezuela implemented measures that offered investors financial incentives. These measures included reduced income-tax rates, reduced royalty payments, and other legal protections against government measures that might harm the investments.[1]

Against this backdrop, on November 10, 1995, the Petrozuata Association Agreement ("Petrozuata AA") was concluded between PDVSA Petroleo (a subsidiary of PDVSA) and CPZ, which established the corporate structure for the Petrozuata Project.[2] The objective of the Petrozuata Project was to "produce, transport and upgrade extra-heavy crude oil, and to market and sell the resulting synthetic crude oil as well as other by-products."[3] On the same date, PDVSA executed the Petrozuata Guaranty in favor of CPZ, essentially guaranteeing the observance of the obligations PDVSA Petroleo assumed in the Petrozuata AA.[4] Similar to the Petrozuata AA, the Hamaca Association Agreement ("Hamaca AA") was concluded on July 9, 1997 between CPH and Corpoguanipa, and the Hamaca Guarantee was concluded on the same date. Both the Petrozuata AA and the Hamaca AA incorporated provisions that obligated the concerned PDVSA subsidiary to indemnify the concerned Claimant against any Discriminatory Actions ("DAs") by the Government.[5]

In December 1998, Hugo Chavez was elected president of Venezuela. One of Chavez's main goals was to reform the oil industry and secure this resource for the benefit of Venezuela and its people. The Venezuelan Government subsequently adopted a series of measures that, according to the Claimants, amounted to a series of coordinated steps formulated jointly by the Respondents and the Government with the express object of taking the Projects. These measures culminated in the nationalization of the Claimants' investment in May 2007, following the passing of the 2007 Nationalization Decree.[6]

On October 10, 2014, the Claimants submitted the Request for Arbitration against the Respondents to "recover the amounts due to the Claimants arising

from the Respondents' breaches of their obligations under the AAs . . . the guarantees, and Venezuelan law, and alternatively to determine the amounts due to the Claimants under the indemnification formulae in the AAs."[7]

Liability

The Claimants' claims can be summarized as follows:

- The Discriminatory Action Claim ("DA Claim"): The Claimants submit that Venezuela's measures (including, *inter alia,* the income tax increase and the dispossession of the Claimants' full interests in the Projects) constitute DAs, for which compensation is due.[8]
- The Willful Breach Claims: The Claimants allege that the Respondents' (i) failure to use reasonable commercial efforts to ensure the success of the Projects; and (ii) non-performance of the AAs and the Guarantees constitute a willful breach of the Respondents' contractual obligations and engage their civil liability under Venezuelan law.[9]
- *Hecho Ilicito* (or tortious interference): The Claimants argue that, in the alternative, the Respondents' willful destruction of the AAs "also attracts liability under the principle of *Hecho Ilícito"* under the Venezuelan Civil Code.[10]

The Respondent Corpoguanipa raised a counterclaim under the Hamaca AA for a declaration that, in the event it is found liable for the DA under the Hamaca AA, it will be entitled to exercise the option provided under the Hamaca AA to purchase CPH's rights and interests in the Hamaca Project.[11]

The Tribunal held partly in favor of the Claimants. With respect to the Claimants' DA Claim, the Tribunal held that the Claimants are entitled: (i) to receive compensation under the Petrozuata AA for the harm caused by the Expropriation, as from 2007, and the income tax increase, as from 2013; and (ii) to obtain compensation under the Hamaca AA for the harm caused both by the Expropriation and by the income tax increase as incurred from the year 2007 onward.[12] The Tribunal dismissed the Claimants' Willful Breach and *Hecho Ilícito* Claims. Corpoguanipa's counterclaim was likewise dismissed.[13]

Quantum

A. Preliminary Matters

In the quantum section of its Final Award, the Tribunal began its analysis by addressing several preliminary issues, namely: (i) the formulae for the calculation of compensation following a DA provided under the Petrozuata AA and the Hamaca AA; (ii) whether an *ex ante* or *ex post* date-of-award valuation should be applied; and (iii) which are the preferred valuation model and valuation date among those that the Parties' respective experts put forth. The Tribunal's analysis with respect to these issues is summarized below.

(i) DA Formulae under the Petrozuata AA and Hamaca AA

With respect to the DA compensation mechanism under the Petrozuata AA, the Tribunal acknowledged that the Petrozuata "AA "lacks a contractually defined exact formula to establish the harm against which the Claimants can claim compensation under the DA Provisions."[14] However, the Tribunal also "note[d] the Parties' implicit agreement as to the general mechanics and quantum inputs," and noted that the main difference between the Parties' experts "lies in the methodology adopted to arrive at the actual values of [the] inputs."[15]

Based on the Parties' submissions and their respective quantum experts' reports, the Tribunal summarized the general DA compensation mechanism under the Petrozuata AA as follows:

a. Qualified measures must have caused the Claimants economic harm in any given fiscal year greater than USD 6.5 million in Yr. 1994 USD (*i.e.* [Significant Economic Damage pursuant to the Petrozuata AA]). If not, then no compensation is owed by the Respondents. . . .

b. If the economic harm for a given fiscal year is between the minimum of USD 6.5 million and USD 75 million in Yr. 1994 USD, then compensation is set pursuant to a sliding scale determined by a range of average Brent crude oil ("Brent") prices. Accordingly, the indemnity by the Respondents will be 0% of the damages suffered by the Claimants (or nil indemnity) when the average Brent price for the given fiscal year (deflated to Yr. 1994 USD) is greater than or equal to USD 25 per barrel. In turn, the indemnity by the Respondents will be 100% of the damages suffered by the Claimants when the average Brent price for the given fiscal year (again deflated to Yr. 1994 USD) is less than or equal to USD 18 per barrel. In between these Brent prices (*i.e.* USD 18 and USD 25 per barrel), the percentage of the Respondents' indemnity obligation will decrease by approximately 14% for every USD 1 increase in the Brent price.

c. If the economic harm suffered by the Claimants for a given fiscal year is greater than USD 75 million in Yr. 1994 USD, then the compensation obligation by the Respondents is equal to the greater of: (i) 25% of the economic damages suffered by the Claimants; or (ii) the amount determined in accordance with the Brent price sliding scale.

d. If the harm is greater than USD 75 million in Yr. 1994 USD, and for the relevant time period the Brent price has been greater than USD 25 per barrel in yr. 1994 USD, then establishing the Respondents' indemnity obligation does not require the use of the Brent price sliding formula: compensation to the Claimants is set at 25% of the harm suffered by the Claimants as a result of the discriminatory qualified measures at issue.[16]

It was common ground between the Parties that, since the adoption of the Income Tax Increase and the Expropriation in 2007, the annual average Brent price has always been greater than USD 25 per barrel in Yr. 1994 USD. The same could be expected and safely projected for the remainder of the original term of the Petrozuata AA, *i.e.*, until 2036.[17] The Tribunal therefore held that the Respondents' indemnity obligation under the Petrozuata AA for the harm caused by the Income Tax Increase and the Expropriation is equivalent to either: (i) "25% of the corresponding harm as long as the said harm for any given year exceeds USD 75 million in Yr. 1994 USD"; or (ii) "0% of the corresponding harm if said harm for any given year fails to exceed USD 75 million in Yr. 1994 USD."[18]

With respect to the Hamaca AA, the contractual provisions set out a specific formula for the computation of damages in the event of harm caused by DAs. The Tribunal noted that, in sum, "the overall exercise required to calculate the compensation owed by the Respondents under the Hamaca AA . . . entails 'determ[ining] the present value of lost past and future cash flows.'"[19]

The Claimants asserted that the DA compensation provisions of the Hamaca AA required a two-step inquiry. Step 1 inquired whether "the Material Adverse Effect threshold [has] been met."[20] The Hamaca AA required that the Discriminatory Action or Actions have a minimum economic impact, and the

threshold under the Hamaca AA was defined as a percentage reduction in the Reference Net Cash Flow ("RNCF").[21] Specifically, "a Discriminatory Action will have caused a Material Adverse Effect if there is a 5% or greater difference between: (i) cash flows to Claimant CPH in the but-for scenario, assuming no discriminatory measures; and (ii) actual cash flows to Claimant CPH (as reduced by the Measures)."[22]

As regards Step 1, the Tribunal found that "it is undisputed that the Claimants must demonstrate the existence of [a Material Adverse Effect] in order to be entitled to compensation under the Hamaca AA", and "[a]ccordingly, 'Step 1' of the Claimants' proposed inquiry corresponds to the text of the Hamaca DA provisions."[23]

The Claimants' proposed Step 2 required "determining the amount of indemnification," which would be calculated as follows:

a. calculate the [RNCF] without the effect of the Discriminatory Action or Actions (*i.e.*, the but-for scenario) for each year from 2007 through the expiration of the Hamaca AA in 2037;

b. subtract the actual cash flows received by Claimant CPH in each of those years; and

c. determine the present value of the lost cash flows by updating past losses and discounting future losses.[24]

The Tribunal determined that Step 2 of the Claimants' suggested inquiry was incomplete. That is because after the "Initial Period" (as defined under the Hamaca AA), the provisions of the Hamaca AA provided that "a second benchmark must be taken into account in addition to the RNCF, namely the Threshold Cash Flow ('TCF')."[25] The TCF is calculated in the same way as the RNCF, but with the following input adjustment:

> SR will be calculated by replacing the Reference Price with the Adjusted Price . . . . 'Adjusted Price' shall mean that price for Commercial Production determined in accordance with a formula established by the Board from time to time pursuant to Section 4.8(a)(xxvii) that reflects the market price for Commercial Production which would exist if the Price for Brent Crude Oil were $27.00, taking into account the quality differential between Commercial Production and Brent crude. Notwithstanding the foregoing, if the Board has not established the formula for determining the Adjusted Price . . . any Party may request that such formula be determined by an expert.[26]

The Tribunal noted that the Initial Period elapsed at the end of 2007, and that "[a]s such, harm exceeding the minimum [Material Adverse Effect] will not be compensated if the average RNCF for any given year and the two prior years is greater than the average TCF for the same three-year period."[27] If the average RNCF was lower than the average TCF, "then compensation to the claimants is calculated as the less of: (i) the actual damages suffered; and (ii) the difference between the [TCF] and the [RNCF]."[28]

The Tribunal then noted that "since the Expropriation, the Claimants' RNCF is nil," which "translates into a reduction in the Claimants' cash flow of 100%."[29] Further, "Brent has been trading upwards of USD 27 per barrel since 2007 and is expected to continue doing so."[30] Therefore, the Tribunal found that the "actual harm suffered by the Claimants due to the Income Tax Increase and the Expropriation has most certainly exceeded the average TCF for the relevant period" and "the compensation owed to the Claimants as a result of the DAs at issue is 'simply equal to the [TCF.]'"[31]

(ii) Ex Post and Ex Ante Quantum Assessment

The Tribunal noted that since the outset of the case, both Parties argued in favor of an *ex post* date-of-award valuation as the most appropriate standard for the calculation of damages under Venezuelan law. However, the Parties were not in agreement on whether to use *ex post* or *ex ante* principles for the relevant historical data comprising the key inputs necessary to determine the compensation owed under the DA provisions of the AAs.[32]

The Claimants' position was that an *ex ante* approach should be taken, and accordingly, the agreed pre-Expropriation production profiles and the agreed cost projections in the pre-Expropriation business planning documents constituted the best evidence of what the Projects could have reasonably been expected to achieve but for the Expropriation. The Respondents argued, *inter alia,* that the Claimants' approach put them in a better position than they would have been in had they remained in the Project, because the Claimants "(i) take advantage of any post-Expropriation development, such as capturing the benefit of the increase in oil prices; and (ii) at the same time ignore any increase in the Projects' actual costs and their decline in production by defaulting into pre-Expropriation projections."[33]

The Tribunal determined that an *ex post* date-of-award valuation was appropriate. Accordingly, as a general rule, it assessed quantum items against actual historical data, as opposed to pre-Expropriation projections. However, if the *ex post* data with respect to a particular quantum issue proved to be speculative (e.g., as a result of being unsubstantiated or unreliable), the Tribunal considered and applied *ex ante* projections instead.[34]

(iii) Valuation Model and Valuation Date

The Parties relied on their respective experts' valuation models in their post-hearing briefs. On this issue, the Tribunal considered that the Claimants' valuation model constituted the most appropriate model for the Tribunal to establish the indemnity owed to the Claimants under the DA provisions for several reasons.

First, the Claimants' model better differentiated between the various quantum aspects of the Willful Breach Claim and the DA Claim, which allowed the Tribunal to verify the impact that the DA Claim had independent of the Willful Breach Claim (which the Tribunal dismissed).[35]

Second, the Claimants' model allowed toggling the disputed quantum inputs at issue in a way that "better represented the Parties' argumentative structure" on the relevant issues.[36]

Third, the Claimants' model used a valuation date of May 27, 2016, which was the last common date between the Parties (up to the hearing) for quantifying the indemnity owed to the Claimants pursuant to the DA provisions of each AA. The Tribunal reasoned that "the Parties have had the opportunity of thoroughly reviewing and commenting on the valuation of the Claimants' DA Claim as of 27 May 2016."[37] The Respondents' valuation model offered an *ex post* quantum assessment as of December 31, 2016, but the Tribunal noted that "it seems contrary to due process and good practice considerations to opt for a different valuation date post-Hearing."[38]

Fourth, the Claimants requested relief as a function of damages calculations as of May 27, 2016 (*i.e.*, the same valuation date as in the Claimants' model). Given the consistency between the valuation date in the Claimants' submission and the model, the Tribunal reasoned that it would be well positioned to assess whether the Claimants' quantum submissions were indeed supported by their expert evidence.[39]

B. The Various Inputs with which the DA Compensation was Calculated

Having addressed the DA formulae, the valuation model, and other preliminary issues, the Tribunal then turned to assessing the Parties' positions on each of the inputs from which the DA compensation was to be calculated, namely production volumes, oil prices, project costs, and the applicable fiscal regime (e.g., taxes). These inputs are further discussed in the sections below.

(i) Production Volumes

The Tribunal separated its analysis with respect to production volumes into two parts. First, the Tribunal addressed: (i) the methodology adopted for arriving at the production volumes; and (ii) the reserve figures, as they were issues common to both the Petrozuata and Hamaca projects. Second, the Tribunal addressed the issues specific to each Project.

a. Methodology adopted for determining the production volumes for the Projects

The Claimants' approach to establishing oil production was to determine the volume of oil that both Projects would have produced had the Claimants remained in possession of the investment.[40] The Respondents based their production profile on "what [actually] transpired in the historical period through 2015, as well as the assessment of the EHCO production capacity at the [Petrozuata and Huyapari fields] by their expert [for the future period]."[41]

The Claimants disagreed with the accuracy of using historical figures for the post-Expropriation performance of the Projects, arguing, *inter alia*, that since the Expropriation, the Projects had been majority owned and controlled by PDVSA (with different priorities and capabilities from private commercial entities such as the Claimants), that PDVSA suffered a "brain-drain" with the dismissal of over 18,000 employees during the Chavez administration, and that there had been repeated and widespread reports of mismanagement and corruption by PDVSA.[42]

The Tribunal took the view that "a post-Expropriation production profile that takes into account actual production figures should be adopted in the instant case,"[43] and agreed with the Respondents that "a date of award or *ex post* valuation should take into account actual post-nationalization information about the Project, unless the Tribunal finds for any reason that such information is either unreliable or has not been sufficiently proved."[44]

The Tribunal further reasoned that there were likely to be several variables that cannot be accounted for in any business projections, and thus it was not persuaded by the Claimants' reliance on pre-Expropriation forecasts to establish production figures. The Tribunal also found that the Claimants had not demonstrated that the Project performed less profitably because of the Respondents. Thus, the Tribunal concluded that the Respondents' production profile should be adopted.[45]

b. Reserves figures

The Claimants alleged that they would have recovered additional oil volumes using enhanced oil recovery techniques, and the reliability of their pre-Expropriation production forecasts was corroborated by the Respondents' own proved reserves figures for each Project. The Tribunal noted that the reliance on proved reserves was only to corroborate the Claimants' production profile and to call into question the purportedly low production profile proposed by the Respondents. On this issue, the Tribunal already adopted the Respondents' production profile.[46] Further and in any event, the Tribunal was not convinced by the Claimants' arguments, stating that "the Claimants' statement has not been substantiated in any manner."[47]

c Production issues specific to the Petrozuata Project

The Respondents raised two issues with regard to the production forecast of the Petrozuata Project: (i) there was a downward trend in production at the Petrozuata Project even prior to the Expropriation in 2007 and this trend would likely have continued thereafter; and (ii) in the post-Expropriation period, the upgrader experienced significant periods of downtime (resulting from equipment failures and operational errors such that it placed a constraint on the production of Commercial Crude Oil ("CCO")) that needed to be factored into Petrozuata's production profile.[48]

With respect to the first issue, the Tribunal noted that the reason the Respondents made this argument was to call into question the Claimant's pre-Expropriation production forecast, and since the Tribunal had already decided to adopt the Respondents' production forecasts, the Tribunal did not need to reach a decision on this argument.[49]

As regards the second issue, the Tribunal found the Respondents' allegations regarding the Petrozuata upgrader without merit, as the Respondents had failed to produce any documentation relating to the alleged serious problems at the Petrozuata upgrader.[50]

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d. Production issues specific to the Hamaca Project

With respect to the Hamaca Project, the Respondents raised three downstream issues that, in their view, affected the production forecast for the Hamaca Project.

First, the Respondents asserted that the Hamaca upgrader's on-stream factor ("OSF"), which is a measure of the performance or capacity of the upgrader, was 72.85%. In contrast, the Claimants proposed an OSF of 91%. The Respondents asserted that their 72.85% OSF was "supported by the entire record in these proceedings," and "[w]hile the Claimants would like to believe that a project in which ConocoPhillips, along with Chevron and PDVSA, was a partner would have performed better, there is no basis whatsoever for the assertion that the 'but for' world would have been any brighter for the Hamaca upgrader."[51]

Second, the Respondents asserted that the upgrader also suffered from serious vibration problems at its coking structure, and that "the problems with the coker unit were of sufficient magnitude to affect the upgrader's performance . . . and create the risk of catastrophic failure," which should be "accounted for in the assessment of the Claimants' damages."[52] Accordingly, the Respondents' experts "assume[d] in each year a 90% probability that the Hamaca upgrader will keep operating and a 10% probability that the Hamaca upgrader will stop operating," which would cause the Hamaca Project to "cease operations."[53]

Third, there were other operational issues that had an impact on production, including corrosion, low EHCO quality, and the collapse of Tank 12.[54]

As regards the first issue, the Tribunal was of the view that the Respondents' OSF estimate for the Hamaca upgrader was more reliable and should be accepted. The Tribunal found that none of the documents on which the Claimants relied supported the OSF of 91%. Further, the studies undertaken prior to the Expropriation by independent third parties predicted reduced OSF, and a 93% OSF (which was the original goal of the Hamaca Project) was considered "aspirational at best." The Claimants were also unable to disprove the OSF proposed by the Respondents.[55]

On the second issue, the Tribunal noted the Respondents' position that "[i]n light of the upgrader's very poor OSF due to other issues, the vibration problem at the coker unit has not had a substantial impact on CCO production to date";[56] however, "if the throughput capabilities at the upgrader were to improve significantly . . . the coker unit would have to operate at higher severity, exacerbating the risks associated with the vibrations."[57] The implication was that if the Tribunal accepted the Respondents' OSF value, "the 'catastrophic failure' of the coker unit would no longer persist" and "need not be accounted for."[58]

As to the third issue, the Tribunal found that the operational issues did not materially impact the decision to prefer the Respondents' production forecast and therefore did not need to be decided.[59]

(ii) Oil Prices

The Tribunal noted that the market price for the Projects' production prospects was an essential item under the DA compensation provisions of both AAs. In this regard, the Tribunal noted that the Parties and their experts coincided on the mechanics behind the calculation of the Projects' price variable:

> Indeed, both Parties: (i) refer to Brent and Maya as the two main pricing benchmarks; (ii) elaborate a Brent price projection until the expiration of the Projects; (iii) calculate a Brent-Maya differential in order to project the price of Maya into the future period; and (iv) finally, calculate a Maya-Petrozuata CCO differential and a Maya-Hamaca CCO differential to determine the price at which the Projects' production volumes would have sold had the DAs at issue not been enacted. In doing so, the Parties account for the quantum constrains imposed by the pertinent DA provisions . . . . Overall, the application of the DA formulae is not controversial.[60]

The Tribunal noted that the Parties disagreed only on "the scope of the data considered in the application of the DA formulae, the justification for the respective choices, and certain underlying assumptions in relation to some of the relevant variables."[61] The Tribunal then listed five specific issues on which the Parties disagreed and proceeded to address these issues in turn.

a. Brent price benchmark

The first issue was whether the price of the Brent crude benchmark should be assumed to remain nominally flat from 2021 onward (until the original expiration date of the Projects) without adjusting for inflation.[62]

The Respondents argued that it was appropriate to assume that, from 2020 onward, the price of Brent would remain equal in nominal terms without adjusting for inflation. This is because long-term Brent projections beyond 2020 are unreliable, and it is "equally incorrect to accept 'simplistic rules such as increases with inflation.'" The Claimants contended that there were no grounds to sustain this assumption.[63]

The Tribunal considered the Respondents' argument convincing because: (i) the Claimants and their expert did not challenge the Respondents' assessment of the recent developments in the oil market industry underlying the Respondents' Brent assumptions; (ii) the sample of long-term Brent pricing forecasts considered by the Claimants seemed insufficient and unconvincing; and (iii) the evidence on record suggested that long-term forecasts are particularly speculative. However, the Tribunal held that the Claimants' assumption of a 2% yearly inflation rate applicable to Brent was reasonable, and applied this inflation rate to the Respondents' post-2020 Brent forecast.[64]

b. Brent-Maya differential

The second issue was whether the Respondents' assessment of additional forecasts was adequate in determining the Brent-Maya differential.[65] The Claimants argued in favor of a Maya differential of a 13.78% discount to Brent (*i.e.*, Maya is projected to trade at 86.22% of the determined Brent forecast), while the Respondents submitted that a 14.11% differential was more appropriate.[66]

The Tribunal noted that the difference between the Parties' figures boiled down to the Respondents' consideration of additional independent analyses forecasting both Brent and Maya prices throughout the relevant forecast period. The Tribunal then observed that the Respondents' "expansion of the pool of assessed forecasts is apposite for the purposes of achieving a more solid statistical sample," and therefore adopted the Respondents' 14.11% differential.[67]

c. Maya-Petrozuata CCO differential

The third issue was whether it was appropriate and accurate to set the Maya-Petrozuata CCO differential at 100% (*i.e.*, that the Petrozuata CCO would trade on par with Maya). The Claimants calculated a differential of 0%, while the Respondents calculated a differential of 0.08%.[68]

The Tribunal observed that the Parties were in virtual agreement on this point, but ultimately adopted the Respondents' calculation because: (i) the Claimants' calculation was premised on the observation that historically, the Petrozuata CCO has traded at or close to the price of Maya, which "tolerates variations such as the 0.08%";[69] (ii) the Claimants' expert did not consider the Respondents' experts' calculations to be erroneous;[70] (iii) the Claimants' expert accepted that the Respondents' experts' calculations were based on "updated information on Petrozuata syncrude prices";[71] and (iv) the Claimants' expert stated that his calculation of the differential had been updated by applying the actual information introduced by the Respondents for the historical period, and yet he insisted on a differential (which the Tribunal found to be contradictory).[72]

d. The Maya-Hamaca CCO differential

The fourth issue was whether the price of the lower-quality CCO sold by the Hamaca Project from 2008 onward should be considered in the calculation of the Maya-Hamaca CCO differential.[73]

The Tribunal noted that, post-Expropriation, the Hamaca Project had effectively sold lower-quality CCO at a discount to Maya. However, the Tribunal established that the changes in the CCO quality were not attributable to the Respondents' actions, and accordingly, "there is no reason to depart from the *ex post* historical price data provided by the Respondents (denoting that Hamaca CCO has traded at a discount to Maya)."[74]

e. By-products

The fifth issue was (i) whether the DA provisions of the Hamaca AA excluded the revenues of by-products; and (ii) which of the sources and methodologies the Parties proposed to define the historical and future periods germane to oil by-products were preferable.[75]

The Tribunal observed that the exclusion of by-product sales from the compensation owed to the Claimants under the DA provisions of the Hamaca AA was uncontroversial.[76] The Tribunal therefore did not find it necessary to make a determination on this issue.[77]

With respect to coke and sulfur, the Respondents' experts relied on historical figures to establish the prices from 2007 to 2015. They then calculated the average differentials to Brent, which they used to project their coke and sulfur prices from 2016 onward. The Claimants' quantum expert adopted the same underlying methodology, but obtained the corresponding Brent differentials from historical data running from 2005 to 2007 (*i.e.*, pre-Expropriation). The Tribunal opined that in this case, *ex ante* data may be preferable because the Respondents' experts' *ex post* data seemed to be unsourced and unsubstantiated. The Tribunal therefore adopted the Claimants' calculation based on data.[78]

With regard to LPG, the Tribunal found the Respondents' calculation (based on differentials included in the ConocoPhillips Composite Economic Model) to be more reliable than the Claimants' calculation (which the Tribunal noted was "unclear as to the sources utilized for the calculation").[79]

(iii) Project Costs

The Tribunal proceeded to assess the Projects' costs, which it noted comprised two sub-inputs: "first, whether actual costs incurred post-Expropriation should be accounted for in the costs projections and to what extent; and second, how should the overall costs be adjusted to account for macroeconomic factors such as inflation and prevailing exchange rate between the Venezuelan Bolivar and USD."[80]

a. Whether the Projects' cost projections should include post-Expropriation "additional costs"

On this issue, the Tribunal noted that the dispute between the Parties was whether the following should be included as part of Project costs in an *ex post* valuation: (i) well repair costs; (ii) costs incurred toward solids handling at the Petrozuata Project; (iii) costs incurred toward the Restoration Plan for Critical Assets ("PRAC") and the Restoration Plan for Major Equipment ("PREM") in connection with the Hamaca upgrader; (iv) drilling and related costs; (v) costs associated with upgrader turnaround at both Projects; and (vi) costs associated with electricity generation, installation of firefighting equipment, and other upgrader-related improvements at the Projects.[81]

With respect to well repair costs, the Tribunal held that the Respondents failed sufficiently to demonstrate the reliability of their costs estimates, which was based on the testimony of a different claimant from a different arbitration and was "not in any way connected to the present arbitration."[82]

As regards the costs incurred toward solids handling at the Petrozuata Project, the Tribunal held that they were attributable to the Respondents' business decision, and as the Claimants correctly pointed out, "no prudent operator would have allowed such costs to be incurred for an extended duration."[83] Accordingly, the Tribunal did not accept these costs.[84]

With respect to the costs incurred toward PRAC and PREM in connection with the Hamaca upgrader, the Tribunal held that the documents to support the Respondents' costs claim for PREM and PRAC "have not been verified in any manner." The Tribunal therefore declined

to accept the Respondents' proposed upgrader maintenance costs.[85]

With regard to the drilling and related costs, the Tribunal first noted that the Parties were in agreement as to the cost of drilling dual lateral wells, and therefore found that additional costs could be included in the post-Expropriation cost estimates. What remained in dispute was the cost of drilling single lateral wells for cold production, as well as whether to account for the cost of wells fitted for EOR. With regard to the cost of drilling lateral wells for cold production, the Tribunal held that the Respondents had not sufficiently established the cost. As regards the cost of wells fitted for EOR, the Tribunal had previously concluded that the Claimants never contemplated implementing EOR techniques at the Projects, and therefore these costs could not be included.[86]

As regards the costs associated with upgrader turnaround, the Tribunal held that the study on which the Respondents relied (which was conducted by Solomon Associates) did not support the Respondents' case in any manner. Apart from the study, the Respondents argued that the turnaround cost estimates were reliable and justified "in light of the fact that these turnarounds were managed by the foreign partners in the Project."[87] However, the Tribunal was of the view that the participation of an international oil company did not in and of itself justify or support the extent of the costs incurred on turnarounds and those estimated for additional turnarounds. Accordingly, the Tribunal adopted the turnaround costs estimated by the Claimants, which the Tribunal considered to be more reliable.[88]

With respect to costs associated with electricity generation, installation of firefighting equipment, and other upgrader-related improvements, the Tribunal held that the inclusion of these costs was justified. The electricity generation installation was mandated by law and not a condition solely attributable to the Respondents. Further, the Respondents produced the invoices necessary to substantiate the installation costs. With respect to the firefighting equipment, the Tribunal found that the Respondents had sufficiently substantiated the costs through testimony and invoices. Accordingly, the Tribunal held that the costs incurred toward firefighting equipment should be granted in the Respondents' favor.[89]

b. The appropriate inflation and exchange rates

Both Parties' experts adjusted the costs projections to account for inflation and exchange rates. However, they differed on: (i) the methodology by which they calculated the nominal value of the Project costs; and (ii) the inflation and exchange rates they applied.[90]

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The Claimants' key argument on this issue was that any reasonable project manager would have "taken steps to avail of the most favorable exchange rates that existed in Venezuela by financing the Projects operations through intercompany or third party loans or other sources, paying the Projects' suppliers in USD and hiring international suppliers so as to pay them in USD outside Venezuela."[91] However, the Tribunal found the Respondents' position more convincing, as the Claimants did not produce any support for the assumption that but for the Expropriation, the Claimants would have been in a position to take advantage of better and/or more favorable exchange rates and would have actually done so, and that in the process the effect of Venezuela's inflation would have become less pronounced.[92]

(iv) Post-Expropriation Fiscal Regime

With respect to the fiscal regime after the Expropriation, the Claimants argued that "the Income Tax Increase, the Royalty Measure, and the Extraction Tax, are all DAs under both AAs . . . [and] [t]hus, these measures 'should be ignored in determining the indemnification owed.'"[93] In view of this, the Claimants instructed their quantum expert to assume for the purpose of determining the *ex post* scenario under the DA provisions that the Projects "(i) pay the general corporate income tax rate of 34% (not 50%); (ii) benefit . . . from the Royalty Reduction Agreement; and (iii) are not subject to the Extraction Tax."[94] Similarly, the Claimants further argued that several taxation measures not applicable to the Projects pre-Expropriation would constitute DAs if applied to both Projects in the but-for world, and instructed their quantum expert to exclude them in the post-Expropriation DA calculations as well.[95]

The Respondents argued that "there are no grounds to hypothesize that the state of affairs would have been any different post-Expropriation," and that "[t]o the contrary, the principle of full reparation suggests that the correct assumption is to project a but-for scenario that accounts for all the taxation measures applicable today in the Venezuelan oil industry."[96] Otherwise, "the Claimants would artificially place themselves 'in a better position than they would have been in had they remained in the Projects.'"[97]

The Tribunal noted that under the Hamaca AA, the RNCF required the subtraction of taxes from the Project's cash flow, and the TCF accounted only for taxes that did not themselves constitute DAs. Consequently, the determination of the TCF (and thus the but-for scenario) required the exclusion of taxation measures that constituted DAs in their own right.[98] The same conclusion could be reached with respect to the Petrozuata AA. While the Petrozuata AA lacked clear contractual formulae that specified all the relevant variables to calculate compensation, it was common ground between the Parties that the fiscal regime applicable to the Petrozuata Project must be computed along with its cash flow. The Tribunal therefore reasoned that it would be "nonsensical to consider taxation measures in the but-for scenario that, in and of themselves, constitute DAs in the but-for scenario."[99] However, taxation measures that could not be characterized as DAs must remain as relevant inputs in the determination of the *ex post* quantum scenario.[100] Accordingly, the Tribunal held that the calculation of the DA but-for scenario must assume that the Projects were not subject to the Income Tax Increase, but the Royalty Measure and the Extraction Tax had to be deducted from the Projects' cash flow, as they were not DAs.[101]

C. Interest

It was common ground between the Parties that each AA set out the applicable interest rate to bring the lost historical cash flows forward to present value. The Petrozuata AA established a Base Rate of 12-month LIBOR, and the Hamaca AA established a 3-month LIBOR interest rate. However, the Parties disagreed on whether the rates must be granted on a compounded interest basis (as the Claimants argued) or on a simple interest basis (as the Respondents argued). On this issue, the Tribunal applied Venezuelan law and determined that compound interest could not be awarded in the present case. Accordingly, the Tribunal determined that the Hamaca Project's historical yearly indemnifications accrued simple interest quarterly at a 3-month LIBOR rate, while the Petrozuata Project's historical annual indemnifications accrued simple interest annually at 12-month LIBOR.[102]

D. Discount Rate

To bring future cash flows pertaining to the DA Claim to present value (*i.e.*, the date of valuation of May 27, 2016), the Claimants argued in favor of a discount rate of 15.21%. The Claimants arrived at this figure by using the International Capital Asset Pricing Model ("ICAPM") "building blocks" approach and applying a 2.11% baseline risk-free rate, a 6.22% industry risk premium multiplied by a 1.13 unlevered beta, and a 6.1% country risk premium.[103]

The Claimants justified the unlevered cost of equity approach ("unlevered CoE") as opposed to a weighted average cost of capital approach ("WACC") by arguing that "the indemnification amounts owing under the DA provisions are properly characterized as cash flows to equity holders, meaning that the discount rates for the DA provisions scenarios are based on the Projects' cost of equity, rather than the weighted average of the cost of equity and cost of debt, as reflected in the WACC."[104] In light of this, the Claimants submitted that their discount rate of 15.21% was reasonable, and consistent with: "(i) the rates used by the Project participants and their affiliates throughout their relationship; and (ii) the rates Respondents apply to their other hydrocarbon projects in Venezuela today."[105]

The Claimants further argued that their discount rate was also "consistent with those adopted in other arbitration awards in comparable cases, such as Occidental Petroleum (applying a 12% discount rate), Enron (applying a 12.6% discount rate), and Gold Reserve (applying a discount rate of 10.09%)."[106]

The Respondents also adopted the "building blocks" approach considering ICAPM, but incorporated other methods. They argued in favor of a WACC or discount rate of 27.7%, which is composed of a 2.1% risk-free rate, a 5.8% industry risk premium, a 17.8% country risk premium, and a 2.0% Discount for Lack of Marketability ("DLOM").

The Respondents opted for a WACC approach (as opposed to an unlevered CoE analysis) because "the valuation with respect to the AAs (be it under the Willful Breach Claim or the DA Claim) must respond to the 'correct fair market value of the projects' vis-à-vis any 'prospective arm's-length buyer of the Projects,'" and therefore "as far as the discount rate applicable to future cash flows is concerned, there are no reasons to make distinctions between the Willful Breach and DA scenarios."[107] The Respondents therefore contended that their 27.7% discount rate was appropriate, as it was consistent with: (i) other cases involving the same nationalization; (ii) the "relation between the notions of [Internal Rate of Return ("IRR")] and discount rate"; and (iii) the "statements made by Claimants' own representatives and the positions taken by Claimants, their experts and their counsel in other proceedings."[108]

The Tribunal first agreed with the Claimants' assumption that the indemnification amounts owing under the DA provisions were properly characterized as "cash flows to equity holders" or a "stream of equity cash flows to Claimants, which ought to be paid by the state-owned equity holder in each Project."[109]

The Tribunal further noted that the overarching areas of disagreement were: (i) the Respondents' 2.0% DLOM; and (ii) the considerable difference between the Parties' estimation of the country risk premium.[110]

With respect to the 2.0% DLOM, the Tribunal found that a DLOM is not justified "on the mere basis that the Projects might face 'minimal' exit costs," and because the 2% DLOM is not based on data reflecting the particular factual circumstances of the Projects.[111]

As regards the country risk premium, the Claimants submitted that the Projects would not have been fully exposed to Venezuelan country risk. The Tribunal was of the view that "it is spurious to accept that all country-specific factors affecting production schedules and profits would have been avoided" because (i) while the Claimants produced and traded a commodity whose revenues were primarily obtained in USD, it would not be accurate to state that such revenue could have remained in USD; (ii) while the Project acquired critical items from international markets, they did use local capital and were therefore not immune to supply chain disruptions; and (iii) the production facilities were unmovable.[112] However, the Claimants were correct that the Projects had the benefit of legal protections designed to reduce their exposure to adverse governmental actions, such as the DA provisions and investment treaty arbitration.[113]

Accordingly, the Tribunal decided that the country risk premium (or the equity impact of country risk) could be appropriately set at 8.89%.[114]

E. Other Issues

The Tribunal next addressed other issues that, "while having certain impact on quantum, have not been subject to major contention between the Parties."[115] These issues were: (i) fiscal maximization; (ii) Hamaca Project debt; (iii) science and technology contribution; (iv) post-award interest; (v) methodology for calculating net present value of equity; (vi) working capital, depreciation, and other revenues; (vii) methodology for calculating net present value of equity; (viii) working capital, depreciation, and other revenues; (ix) tax net award; and (x) reimbursement to the Respondents.

(i) Fiscal Maximization

The Respondents' experts adopted a "fiscal maximization" assumption, which means that but for the Expropriation, it would have been reasonable to assume that the Government would not have stood by and allowed the association to capture the benefits of high oil prices. Rather, it would have exercised its sovereign powers to obtain the benefits of these exceptional profits.[116]

The Tribunal considered that the fiscal maximization assumption was only relevant to the quantification of damages arising out of the Willful Breach Claims and not the quantification of compensation under the DA claims. Therefore, the Tribunal did not find it necessary to determine the correctness of this assumption.[117]

(ii) Hamaca Project Debt

In their calculations of the compensation payable under the DA provisions of the Hamaca AA, the Respondents' experts deducted from the Project's annual cash flows the amount of debt payable by the Hamaca Project to its lenders, while the Claimants' expert did not deduct the outstanding debt.[118]

On this issue, the Tribunal held that the outstanding debt of the Hamaca Project did not need to be deducted from the Project's cash flows to arrive at the compensation payable to the Claimants under the Hamaca AA. The Tribunal noted that, although an ordinary market valuation of the compensation due to the Claimants for a harmful act could have required deduction of outstanding debt from the Hamaca Project's revenues, the situation was not the

same in this instance because the calculation of compensation was not based on the standard market approach—it was governed by a specific formula agreed upon by the Parties.[119]

(iii) Science and Technology Contribution

The Parties agreed that oil and gas companies are required to contribute a certain percentage of their yearly gross revenues to the advancement of science, technology, and innovation in Venezuela (2% from 2005 through 2010, and 1% from 2011 until the expiration of the Projects).[120] However, the Claimants argued that this would apply to the Projects' current year gross revenues obtained from the sale of hydrocarbons only, while the Respondents submitted that this applied to the Project's previous year's total gross revenues.[121]

On this issue, the Tribunal determined that the Science and Technology Contribution must be applied to the *ex post* scenario as calculated by the Respondents, because the statutory provision (i) supports the application of the Science and Technology Contribution to the previous year's gross income; and (ii) supports the position that the Science and Technology Contribution covers more than just the revenues obtained from the sale of hydrocarbon.[122]

(iv) Post-Award Interest

The Claimants requested post-award compound interest, and the Tribunal noted that the Respondents did not seem to dispute this position.[123]

The Tribunal held that "given that the simple interest on the lost cash flows are predicated on the Respondents' belated compliance with their indemnity obligations under the DA provisions" (*i.e.*, delayed payment), the Tribunal found no reason "to differentiate between the [interest] rate [and conditions] applicable to [the] delayed payment of damages prior to or after the [a]ward."[124]

The Tribunal therefore granted post-award interest, but on a simple interest basis, which was to run from May 27, 2016, in accordance with the Claimants' expert's valuation model, until the date of full and final payment of the awarded amount at (i) 12-month LIBOR in relation to the amount awarded pursuant to the Petrozuata AA; and (ii) 3-month LIBOR in relation to the amount awarded pursuant to the Hamaca AA.[125]

(v) Methodology for Calculating Net Present Value of Equity

To calculate the net present value of equity for the DA claim in the post-date of valuation period, the Claimants' expert applied the free cash flows to equity ("FCFE") method of valuation, and the Respondents applied a free cash flows to firm ("FCFF") method of valuation. The Tribunal considered that the Claimants' approach was preferred, because "applying the Respondents' methodology results in a situation where the Projects become uneconomical on a post-tax basis starting from 2015 and become permanently loss making in and around 2023 (Petrozuata) and 2027 (Hamaca)."[126]

(vi) Working Capital, Depreciation, and Other Revenues

With respect to working capital (i.e., the amount of cash that a company needs to retain to ensure the sound operation of its business on a day-to-day basis), the Tribunal observed that the Parties' experts agreed on the methodology to be adopted to arrive at working capital requirements but differed only on the inputs. Because the Claimants' expert opined that the differences in calculation did not give rise to material valuation differences, the Tribunal adopted the Respondents' working capital estimates.[127]

As regards the issue of depreciation, the Tribunal found that the key issue in dispute pertained to the methodology to be followed for depreciating the Projects' assets (and in particular, how the upgrader should be depreciated). The Claimants alleged that their depreciation methodology was based on the depreciation methodology in the Projects' financial statements, but the Tribunal found that this was not supported by documentary evidence. Rather, the financial statements reflected the methodology the Respondents applied. In the circumstances, the Tribunal accepted the Respondents' depreciation calculations.[128]

(vii) Tax Net Award

The Claimants submitted that their discounted cash flow calculation took into account "all applicable Venezuelan taxes," and therefore "no further Venezuelan taxes should be payable on this Tribunal's Award" because "[any] taxation of the Award would result in Claimants impermissibly being taxed twice for the same income."[129] The Claimants therefore requested "(i) for the award to be net of all applicable Venezuelan taxes; and (ii) for the Tribunal to hold that any taxes applying under Venezuelan law to the payment of the award to be borne by the Respondents."[130]

The Tribunal determined that "all of the taxation measures at issue [we]re either applicable or not applicable in the but-for world, or constitute[d] (or would have constituted) DAs".[131] The Tribunal therefore agreed with the Claimants that applying taxes to the amount awarded would have undermined the principle of full compensation and would have allowed impermissible double taxation. Accordingly, the Tribunal granted the Claimants' request for a tax net award.[132]

(viii) Reimbursement to the Respondents

The Claimants clarified that they did not seek double recovery for the damage suffered, and that if the Claimants received payment for damages or indemnification in connection with this proceeding and were later awarded monetary reparation in connection with the related ICSID Arbitration, the Claimants would reimburse the Respondents for the amount that the Respondents paid in this ICC arbitration, after deducting the Claimants' legal and expert costs, to the extent necessary to prevent double recovery.[133]

The Claimants also clarified that the ICSID Tribunal found that it could not award compensation under the BIT for these pre-dispossession fiscal measures due to a carve-out for tax measures in the BIT. As a result of that ruling in the ICSID Arbitration, these ICC proceedings were the only viable recourse for Claimants' losses flowing from the Royalty Increase, the Extraction Tax, and the Income Tax Increase, presented as part of the DA Claim.[134]

F. Costs

The Tribunal noted that both Parties agreed that in determining the allocation of costs, the Tribunal could take into consideration the relative success or failure of the Parties by: (i) assuming that if a Claimant or Respondent succeeded in its core or primary claim or outcome, then it was entitled to all of its reasonable costs; (ii) apportioning costs on a claim-by-claim or issue-by-issue basis according to relative success and failure; or (iii) apportioning success against the amount of damages originally claimed or the value of the property in dispute. The Tribunal also noted that it could consider the manner in which the Parties conducted the case.[135]

Under these circumstances, the Tribunal decided that the relative success of the Parties on the various claims and issues was evenly balanced. Accordingly, it held that it was "just and fair for each Party to bear its own legal fees, costs and expenses," as well as the costs of Arbitration.[136]

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[1] Final Award dated April 24, 2018, *Phillips Petroleum Company Venezuela Limited, ConocoPhillips Petrozuata B.V. v. Petroleos de Venezuela, S.A., Corpoguanipa, S.A., PDVSA Petroleo, S.A.,* ICC Case No. 20549/ASM/JPA (C-20550/ASM) (hereinafter "Final Award"), ¶¶ 13-16.

[2] All capitalized terms that are not defined herein have the meanings given to them in the Table of Abbreviations (pages 8-15) in the Final Award.

[3] Final Award, ¶ 20.

[4] Final Award, ¶¶ 18-19.

[5] Final Award, ¶¶ 22-23.

[6] Final Award, ¶¶ 24-29.

[7] Final Award, ¶ 55.

[8] Final Award, ¶ 94.

[9] Final Award, ¶ 295.

[10] Final Award, ¶ 492.

[11] Final Award, ¶ 77.

[12] Final Award, ¶ 294.

[13] Final Award, ¶ 1163.

[14] Final Award, ¶ 552.

[15] Final Award, ¶¶ 551-552.

[16] Final Award, ¶ 547.

[17] Final Award, ¶ 548.

[18] Final Award, ¶ 549.

[19] Final Award, ¶ 562.

[20] Final Award, ¶ 554.

[21] *See* Final Award, ¶ 553. Under Article 14.2(f) of the Hamaca AA, "the 'Reference Net Cash Flow' of a Party in respect of any Fiscal Year shall equal:
[(SR-DP-EX-ROY-OT) x (1-ITR)] – SC + DP
Where:
SR = (the Party's Project Interest of Commercial Production or Development Production as applicable, multiplied by the applicable Reference Price) plus any compensation received from Corpoven Sub in respect of prior Discriminatory Actions
DP = depreciation calculated on the basis of a 10-year depreciation schedule or, if different, the schedule required by law
EX = the Party's pro rata share of actual expenses of the Association
ROY = the actual royalty rate applicable to the Party's Project Interest of Extra Heavy Oil multiplied by the royalty base
OT = actual Venezuelan taxes paid that are deductible for income tax purposes
ITR = the actual Venezuelan income tax rate applicable to the Party in connection with the Association's activities; and
SC = Venezuelan taxes paid that are not deductible for income tax purposes."

[22] Final Award, ¶ 554.

[23] Final Award, ¶ 555.

[24] Final Award, ¶ 554.

[25] Final Award, ¶ 556.

[26] Final Award, ¶ 557.

[27] Final Award, ¶ 558.

[28] *Id.*

[29] Final Award, ¶ 560.

[30] *Id.*

[31] *Id.*

[32] Final Award, ¶¶ 563-564.

[33] Final Award, ¶ 566.

[34] Final Award, ¶ 580.

[35] Final Award, ¶ 582(i).

[36] Final Award, ¶ 582(ii).

[37] Final Award, ¶ 582(iii).

[38] *Id.*

[39] Final Award, ¶ 583.

[40] Final Award, ¶ 588.

[41] Final Award, ¶ 596.

[42] Final Award, ¶¶ 614-618.

[43] Final Award, ¶ 672.

[44] Final Award, ¶ 673.

[45] Final Award, ¶¶ 673-677.

[46] Final Award, ¶ 713.

[47] Final Award, ¶¶ 714-717.

[48] Final Award, ¶¶ 719-728.

[49] Final Award, ¶ 737.

[50] Final Award, ¶¶ 738-739.

[51] Final Award, ¶¶ 742-749.

[52] Final Award, ¶ 753.

[53] Final Award, ¶ 754.

[54] Final Award, ¶¶ 755-756.

[55] Final Award, ¶¶ 775-785.

[56] Final Award, ¶ 787.

[57] *Id.*

[58] Final Award, ¶ 788.

[59] Final Award, ¶ 789.

[60] Final Award, ¶ 799.

[61] Final Award, ¶ 800.

[62] Final Award, ¶¶ 800(i), 802.

[63] Final Award, ¶¶ 802-805.

[64] Final Award, ¶¶ 806-815.

[65] Final Award, ¶ 800(ii).

[66] Final Award, ¶ 816.

[67] Final Award, ¶ 820.

[68] Final Award, ¶ 800(iii).

[69] Final Award, ¶ 822.

[70] Final Award, ¶ 823.

[71] Final Award, ¶ 824.

[72] Final Award, ¶ 825.

[73] Final Award, ¶ 800(iv).

[74] Final Award, ¶ 829.

[75] Final Award, ¶ 800(v).

[76] Final Award, ¶ 832.

[77] *Id.*

[78] Final Award, ¶¶ 833-834.

[79] Final Award, ¶ 832.

[80] Final Award, ¶ 836.

[81] Final Award, ¶ 852.

[82] Final Award, ¶ 886.

[83] Final Award, ¶ 889.

[84] *Id.*

[85] Final Award, ¶ 893.

[86] Final Award, ¶¶ 896-898.

[87] Final Award, ¶ 901.

[88] Final Award, ¶¶ 899-902.

[89] Final Award, ¶¶ 903-908.

[90] Final Award, ¶ 910.

[91] Final Award, ¶ 938.

[92] Final Award, ¶¶ 938-948.

[93] Final Award, ¶ 949.

[94] *Id.*

[95] Final Award, ¶ 950.

[96] Final Award, ¶ 955.

[97] *Id.*

[98] Final Award, ¶ 957.

[99] Final Award, ¶ 958.

[100] Final Award, ¶ 959.

[101] Final Award, ¶ 960.

[102] Final Award, ¶¶ 999-1014.

[103] Final Award, ¶ 1015.

[104] Final Award, ¶ 1016.

[105] Final Award, ¶ 1017.

[106] Final Award, ¶ 1020.

[107] Final Award, ¶ 1025.

[108] Final Award, ¶ 1026.

[109] Final Award, ¶ 1042.

[110] Final Award, ¶ 1046.

[111] Final Award, ¶¶ 1047-1051.

[112] Final Award, ¶ 1075.

[113] Final Award, ¶ 1075.

[114] Final Award, ¶¶ 1076-1084.

[115] Final Award, ¶ 587.

[116] Final Award, ¶ 1086.

[117] Final Award, ¶¶ 1091-1093.

[118] Final Award, ¶ 1094.

[119] Final Award, ¶¶ 1098-1100.

[120] Final Award, ¶ 1102.

[121] Final Award, ¶ 1103.

[122] Final Award, ¶¶ 1104-1106.

[123] Final Award, ¶ 1107.

[124] Final Award, ¶ 1108.

[125] Final Award, ¶ 1109.

[126] Final Award, ¶¶ 1110-1111.

[127] Final Award, ¶¶ 1113, 1120.

[128] Final Award, ¶ 1119.

[129] Final Award, ¶ 1121.

[130] Final Award, ¶ 1122.

[131] Final Award, ¶ 1124.

[132] *Id.*

[133] Final Award, ¶ 1125.

[134] Final Award, ¶ 1126.

[135] Final Award, ¶¶ 1149-1151.

[136] Final Award, ¶¶ 1149-1157.

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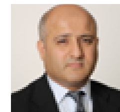
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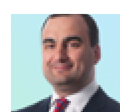
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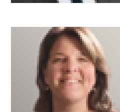
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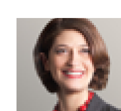
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