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Foreword

We are delighted to present the latest edition of ***Quantum Quarterly***. The world has of course changed dramatically since we last went to print. What impact the pandemic may have on future disputes and quantum issues remains to be seen. In the interim, we present extensive case notes on quantum awards that were rendered or became public since our last edition. These include the groundbreaking ***Tethyan Copper v. Pakistan*** case, in which a tribunal adopted what is believed to be the first use of "modern" DCF in estimating the fair market value of an investment. We hope you enjoy this edition. More importantly, we look forward to 2021 and a hopeful return to normal life. All the best.

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Recent Damages Awards

Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan, ICSID Case No. ARB/12/1

Date of the Award
July 12, 2019

The Parties
Tethyan Copper Company Pty Limited (**Claimant** or **TCCA**), Islamic Republic of Pakistan (**Respondent** or **Pakistan**). Claimant and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties**."

Sector
Mining and quarrying

Applicable Treaty
Bilateral Investment Treaty between Australia and Pakistan

Members of the Tribunal
Professor Dr. Klaus Sachs (president), Dr. Stanimir A. Alexandrov (Claimant's appointee) and Rt. Hon. Lord Leonard Hoffmann (Respondent's appointee)

Background

Claimant is an Australian joint venture between Chile's Antofagasta plc and Canada's Barrick Gold Corporation. In 2006, Claimant became a party to a joint venture agreement between it and the Government of Balochistan with the purpose of exploring for deposits of gold, copper and other minerals in the Chagai district of Balochistan in Pakistan. From 2006, Claimant, together with its wholly owned Pakistani subsidiary, Tethyan Copper Company Pakistan (Private) Limited (**TCCP**, and collectively with TCCA, known as **TCC**), carried out an exploration project known as Reko Diq.

In 2010, Claimant formally submitted a feasibility study envisaged in the joint venture agreement (**Feasibility Study**) to the Government of Balochistan. The Feasibility Study examined the technical and economic feasibility of a base case mining project and its future expansion and concluded that the project would have gone forward and become operational and profitable in due course. The same year, Claimant and TCCP provided

notice to the Government of Balochistan of their election to participate in the development of Reko Diq. In 2011, TCCP submitted an application for a mining lease in Reko Diq (**Lease Application**). This Lease Application was rejected by the Mines & Mineral Development Department of the Licensing Authority (Balochistan) (**Licensing Authority)**. A few days later, TCCP filed an administrative appeal of the order, but it was also denied.

In 2012, Balochistan took steps to implement the Reko Diq Copper & Gold Project, which was approved by the Reko Diq Board of Governors. The Licensing Authority noted that the project was in the national interest.

Following a third-party domestic court action to enjoin the governments of Pakistan and Balochistan from issuing a mining lease, the Pakistani Supreme Court decided in 2013 that the underlying agreement between Claimant and the government was "illegal, void and non est" on the basis that the agreement fell outside the powers granted to state authorities.

On November 28, 2011, Claimant initiated ICSID arbitration against Pakistan, claiming that the denial of the mining lease deprived it of the opportunity to build and operate the mine at Reko Diq. It alleged that Pakistan's actions breached the fair and equal treatment obligation under Article 3(2), expropriated Claimant's investment without compensation in violation of Article 7(1), and resulted in the impairment of Claimant's investment in violation of Article 3(3) of the 1998 Agreement between Australia and the Islamic Republic of Pakistan on the Promotion and Protection of Investments (**BIT**).

After finding Respondent liable for breach of the BIT, the Tribunal awarded Claimant more than **US$4 billion** in damages. The assessment for quantification of damages undertaken in this case is noteworthy in two respects.

First, the case is notable because the Tribunal applied a discounted cash flow (**DCF**) method for a mining project which had not yet become operational. The DCF method is the most common method for valuing an investment on the basis of expectations about future income. The Tribunal's decision to pursue the DCF approach was in large part a result of its conviction that Claimant's Feasibility Study was reliable and thorough in suggesting that the project would have become operational and profitable in due course.

Second, the case is notable because it was the first time a tribunal applied the "modern" DCF method rather than the traditional DCF method in an investment arbitration. As background, the modern and traditional DCF methods differ in the manner in which they allocate the risk captured in the cash flows that an asset is expected to generate. In the modern DCF method, risk is captured in the cash flows themselves, leaving the discount rate to reflect only the time value of money. In contrast, in the traditional DCF method, the cash-flow risk is encapsulated in the discount rate alongside the time value of money. While concluding that the modern DCF approach is appropriate in valuing Claimant's investment in the project at the Reko Diq mine, the Tribunal nevertheless cautioned that the appropriateness of a valuation method could only be selected in the circumstances of each individual case and based on the submissions and evidence brought before that tribunal.

Jurisdiction and Liability

On November 10, 2017, the Tribunal issued its Decision on Jurisdiction and Liability. Claimant prevailed on the matters of jurisdiction, admissibility, liability and the counterclaims raised by Respondent. Specifically, the Tribunal found that it had jurisdiction over Claimant's claims, that such claims were admissible, and that by denying

Claimant's Mining Lease Application, Respondent had breached Articles 3(2), 7(1) and 3(3) of the BIT. The Tribunal decided that Claimant was entitled to compensation for all damages and losses resulting from Respondent's breaches of the BIT, in an amount that would be determined at a subsequent phase of the proceedings. The Tribunal also stated that it had jurisdiction to hear Respondent's counterclaim based on the alleged violation of Article 1(1)(a) of the BIT, but that it did not have jurisdiction to hear Respondent's other counterclaims. The Tribunal dismissed Respondent's counterclaim based on the alleged violation of Article 1(1)(a) of the BIT.

Tribunal's Decision on Respondent's Reconsideration Request

On November 6, 2017, Respondent filed a request for reconsideration of the Tribunal's findings in its Decision on Jurisdiction and Liability on the basis that it had recently discovered evidence that undermined Claimant's claims regarding the results of the drilling for water and the metallurgical drilling. The Tribunal analyzed both sets of new facts but found them irrelevant to the Tribunal's findings on jurisdiction and liability.

Quantum

A. Disqualification Requests

The quantum phase fielded not one – but two – disqualification requests. First, on July 7, 2017, Respondent requested the disqualification of Dr. Stanimir A. Alexandrov. Second, on November 25, 2017, Respondent filed a proposal for disqualification of the entire Tribunal. Both of Respondent's disqualification requests were rejected.

B. Legal Standards Governing Compensation

(i) Standard of Compensation

It was common ground between the Parties and agreed by the Tribunal that the valuation date for purposes of assessing damages would be November 15, 2011, the date the Licensing Authority rejected Claimant's application for the grant of a mining lease.[1] The Parties also agreed that quantification of Claimant's losses required determining the market value of TCC, which involved determining the market value of Claimant's investment in the Reko Diq project as of the valuation date.[2] The Tribunal agreed with the Parties that Claimant's losses would be "equivalent to the (entire) value that its investment would have had if TCCP's Mining Lease Application ha[d] not been denied in violation of Respondent's obligations under the Treaty."[3]

Although Claimant took the position that the Tribunal should apply the customary international law compensation standard set out in *Chorzów Factory*, it also argued its approach was consistent with Article 7 of the BIT.[4] However, in applying Article 7(2) of the BIT, the Parties disagreed as to the criteria for determining compensation "[w]here [market] value cannot be readily ascertained." Claimant argued that the market value of its investment could be determined based on the valuation performed by its valuation expert. Respondent argued that the valuation method proposed by Claimant was not "readily ascertainable" and that the application of other criteria was required, including the "backward-looking approach."[5] Based on the evidence and valuation methods argued before it by Claimant's valuation expert, the Tribunal agreed with Claimant that the market value of Claimant's investment could be "readily ascertained." The Tribunal nevertheless decided to give due consideration to generally recognized principles of valuation to verify whether the result reached under Claimant's method was "reconcilable with the amount of

capital invested by Claimant" and whether it "truly reflects the damages [Claimant] incurred as a result of Respondent's breaches of the Treaty."[6]

(ii) Requirement of Causation

Regarding causation, the Tribunal required Claimant to prove "specific aspects of causation," particularly whether the Reko Diq project would have "succeeded in the manner presented by Claimant and/or whether the assumptions made by Claimant and its valuation expert Prof. Davis reflect the true value of the Reko Diq project."[7] In this regard, the Tribunal reiterated the Parties' agreement that Claimant was only entitled to "compensation in the amount of the value that its investment would have had but for Respondent's breaches" and that any "specific risk or downside affecting Claimant's investment [that] would not have existed in the but-for scenario" would be deducted so that only the losses that were caused by Respondent's breaches to the BIT were compensated.

(iii) Standard and Burden of Proof

While it was undisputed that Claimant had the burden of proof, the parties disagreed over the differences in standards between a "fact of loss" and a "quantum of the loss."[8] Claimant argued that "fact of loss" would be determined pursuant to the "normal standard of balance of the probabilities" and the "quantum of loss" based on a "reasonable basis." In contrast, Respondent argued that the occurrence of both a "fact of loss" and a "quantum of loss" had to be proved with "reasonable, or sufficient, certainty."[9] In determining this point, the Tribunal rejected any possibility that damages had to be proved with "absolute certainty."[10] After surveying the case law cited in *Lemire v. Ukraine* and *Crystallex v. Venezuela*, as well as Respondent's expert's opinion, the Tribunal decided that it did not consider there to be "fundamental uncertainties" with the modern DCF method and that, *if* it reached a conclusion that "certain risks or uncertainties [were] not [] sufficiently accounted for," it would also assess – in that context – the evidentiary uncertainty caused by Respondent and whether Claimant's burden of proof might justify alleviation.

(iv) Appropriate Valuation Method

To determine the valuation of a nonoperational mining project, the Tribunal assessed two valuation methods, namely the (i) modern income-based DCF valuation offered by Claimant, and (ii) the past-transactions-based valuation offered by Respondent. In assessing the two methods, the Tribunal considered two preliminary questions disputed by the Parties, namely: "(i) whether it is appropriate in general to use an income-based DCF valuation for a development-stage mining project in the circumstances of Reko Diq; and (ii) whether it is appropriate to use the modern DCF method, which is in principle also a DCF valuation but, as explained by [Claimant's expert], uses at-source pricing of risk and simulates certain project variables to incorporate managerial flexibility while then discounting cash flows at a risk-free rate."[11]

1. *The appropriateness of DCF methods for nonoperational projects*

With respect to the first question on the appropriateness of the forward-looking DCF method, the Tribunal began by conducting a review of decisions in recent and comparable cases.[12] It determined that the inquiry into whether a DCF method can be applied to value a project which has not yet become operational depends "strongly on the circumstances of the individual case" and on the answers to two questions: *first*,

whether based on the evidence before it, the project "would have become operational and would have also become profitable," and *second*, whether the tribunal is convinced that it can "determine the amount of these profits based on the inputs provided by the Parties' experts for this calculation" with "reasonable confidence."[13]

The Tribunal further clarified that the DCF method cannot be applied if there exist any "fundamental uncertainties" as to whether the project would have reached the operational stage and whether it would have been able to generate profits. However, if there exist no such "fundamental uncertainties" as to the second step, the tribunal could choose whether to apply the DCF method or utilize "certain deductions [] to account for additional risks or uncertainties faced by the project."[14]

The Tribunal concluded that Claimant had sufficiently established, on the basis of the Feasibility Study and the commitment shown by Claimant as well as its two owners, that if Respondent had not denied TCCP's Mining Lease Application in violation of Respondent's obligations under the BIT, the Reko Diq project could have gone forward and become operational and profitable. Indeed, it seems that the Tribunal was persuaded by the appropriateness of a standard of compensation measured by the risk of the investment and the expected returns rather than the "investment actually undertaken,"[15] particularly because Claimant argued (and Respondent did not deny) that, according to prevailing business models in the global mining industry, only 1 in every 10,000 exploration projects results in a productive mine – and the government already knew that the Reko Diq project was that "1-in-10,000 discovery."[16] In coming to its conclusion, the Tribunal rejected Respondent's allegation that the Feasibility Study was a mere "blueprint for another Mega Project failure."[17] This was particularly the case given Claimant and its owners' experience in operating mines, their willingness to make equity contributions, and the secondment of their personnel for the project.[18] The Tribunal acknowledged that although there existed risks and issues associated with "water, security and a social license to operate," as well as "whether and, if so on what terms, Claimant would have concluded a Mineral Agreement with the Governments," neither of these risks or uncertainties constituted a "fundamental uncertainty" that would have "stopped the project or rendered it unprofitable."[19]

The Tribunal next considered whether the inputs for a DCF calculation presented by the Parties' experts provided the Tribunal with a "reasonable basis" to determine future cash flows with a "reasonable amount of confidence."[20] It concluded, despite Respondent's expert's criticisms of the numerous assumptions and inputs, that in the particular circumstances of the case, the DCF method could produce a "sufficiently reliable" result even though certain adjustments would have to be made to the inputs used in Claimant's calculations.[21]

2. *The modern DCF method is a recognized valuation method used in the industry for valuing mining projects*

Having found the general DCF method appropriate for determining the valuation of Claimant's investment, the Tribunal next sought to assess whether the modern DCF approach in particular could be applied in the dispute. Claimant's expert argued "four main shortcomings" of the traditional DCF method when applied to calculating the fair market value of a mining project. The Tribunal summarized these as:

(i) There is no market-based information for the main price and cost drivers of the project for 50 years or more into the future; (ii) there is no reasonable way of knowing how the market would discount the risk in each cash flow for a specific mining project but the standard approach uses market signals from the industry as a whole and uses a constant risk-adjusted discount rate which compounds over the years even though the risk of long-life mining projects is more or less constant over time; (iii) the method underestimates the project's tax cash flows and therefore overestimates net cash flows; and (iv) there is no simulation accounting for the possibility of the project's managers to respond to changing conditions by making appropriate operational decisions.[22]

Out of these shortcomings, the main issue disputed between the Parties' experts was whether the modern DCF method "accurately accounted for all the risks associated with a project and whether it is therefore reasonable to dispute the risk-adjusted cash flows only for the time value of money, i.e., by using a risk-free rate."[23]

To support its position that modern DCF methods have been used by actual buyers in the limited market for large-scale mining enterprises, Claimant had relied on a letter sent by the Special Committee of the Canadian Institute of Mining, Metallurgy and Petroleum on Valuation of Mineral Properties (**CIMVal**) to the International Valuation Standards Council reflecting international best practices in mineral project valuation. The Tribunal carefully considered the CIMVal opinion and found there to be a "strong indication" that, contrary to Respondent's allegations, the modern DCF is used in the industry for valuing mining properties, including advanced-stage exploration property.

This confirmed Claimant's proposal that the modern DCF method is "reasonable and preferable over a traditional DCF method for the valuation of the Reko Diq project."[24] The Tribunal also acknowledged the need to "distinguish between different types of risk and adjust each cash flow component directly for the risks that affect [a] particular cash flow" since it was more preferable to make "reasonable, and perhaps conservative, assumptions" rather than "applying a discount rate that results in almost no net present value for cash flows [] generated in the second half of the mine's life."[25]

Moreover, although a modern DCF had never before been adopted by an arbitral tribunal in determining the amount of damages owed to a claimant in the expropriation of a mining project, the absence of investment treaty jurisprudence was no hindrance to the Tribunal. It determined that it would be appropriate to value Claimant's investment in the Reko Diq project by using the modern DCF approach, adjusting for risks and uncertainties as appropriate, including residual adjustments for risks not explicitly or insufficiently recognized in Claimant's model.

C. Impact of the Risks and Issues Raised by Respondent on the Feasibility and Profitability of the Project

After determining the applicable compensation standard and valuation method, the Tribunal turned to analyzing a number of risks and issues raised by Respondent that would have an impact on the value of Claimant's investment – and whether Claimant's expert had appropriately accounted for each of these risks in his valuation of the project.

(i) The Parties Would Have Concluded a Mineral Agreement

The Parties had disputed both (i) whether a Mineral Agreement would have been concluded at all and, if yes, (ii) the commercial terms of such agreement. Although Respondent argued that there existed "no specific commitment or legal obligation to conclude a Mineral Agreement,"[26] the Tribunal found that a mineral agreement "providing in particular for fiscal stability would have been concluded after the mining lease was granted to TCCP."[27] It further found that with respect to the commercial terms of such agreement, the Parties would have agreed on (i) a sliding scale of royalties, (ii) EPZ status or similar tax concessions, and (iii) a provision regarding the renewal of the mining lease.[28] As for lease renewal, the Tribunal found it necessary to reduce damages to account for the risk that a willing buyer would have realized after acknowledging the possibility that the value of the lease renewal may not materialize and/or that the renewal may not be negotiated on the same commercial terms.[29]

(ii) Claimant Properly Estimated and Classified the Resources Reported in the Feasibility Study

The Tribunal considered whether Claimant established proper resource estimation (i.e., the tonnage and grade (concentration) of metal in a deposit) and classification techniques (i.e., the level of confidence in the predicted resources) in the Feasibility Study. However, as a general consideration, the Tribunal recognized that the Feasibility Study had not been "prepared for the purposes of damages valuation, but rather for the purposes of determining whether the resources available could form the basis of successful mining operations at Reko Diq."[30] After considering expert testimonies, the Tribunal concluded that Claimant's resource estimation and classifications reported in the Feasibility Study accorded with industry practice and the exercise of "good judgment." [31]

(iii) Claimant Sufficiently Confirmed That the Minerals Could Be Economically Extracted

Under this category, the Parties disputed two main issues: (i) whether Claimant collected "adequate and sufficient metallurgical samples" representative of the different types of rock contained in the ore body at Reko Diq, and (ii) whether the metallurgical testing was adequate and "showed the consistent high recoveries reported in the Feasibility Study."[32] Respondent had contended that Claimant did not sufficiently test the deposit and that Claimant's metallurgical testing program was insufficient.[33] However, the Tribunal found that the metallurgical sampling conducted by Claimant was adequate and in line with industry standards and that it did not affect the value attributed by a willing buyer to Claimant's investment.[34]

(iv) Claimant's Plans for Project Execution Were Adequate for a Project at the Development Stage of Reko Diq

The Tribunal also considered whether the plans that Claimant had prepared as of November 2011 were, from the perspective of a buyer, "adequate for a project at the development stage of Reko Diq."[35] The Tribunal rejected Respondent's general arguments that Claimant lacked the necessary expertise to conduct a feasibility study, including plans for construction and execution of the project.[36] After assessing a number of factors, such as the various components

of a project execution plan, construction schedule(s) and workforce productivity estimates, the Tribunal concluded that it had "no reason to believe that Claimant's plans for executing the project and the capital cost estimate, as adjusted by [Claimant's expert], would have been considered inadequate by a buyer in November 2011."[37]

(v.) Claimant Had a Feasible Plan for the Supply of Water to the Project

Claimant also successfully established that none of the issues raised by Respondent would have affected the feasibility of Claimant's plan for the supply of water to the project. Specifically, the Tribunal assessed whether the groundwater source Claimant had chosen could supply sufficient water to the Reko Diq project.[38] Since Respondent had challenged the amounts of water needed for the project (emphasizing that the quantities of water needed for the project equaled the "daily water consumption of approximately 500,000 people"),[39] the Tribunal first assessed whether the estimated mine water demand of the Reko Diq project was reasonable.[40] Subsequently, it looked at whether a sufficient amount of water was available to meet the demand of the project.[41] Finding that there was such availability, the Tribunal next looked at whether it was feasible to extract the water from Fan Sediments, and at the potential impact and costs associated with the extraction.[42] Although there existed expert disagreement on this point, the Tribunal concluded that Claimant's assumptions were nonetheless reasonable under the circumstances.[43] On that basis, the Tribunal reviewed whether Claimant had adequately predicted the "effects of long-term pumping at the Fan Sediments and whether it appropriately accounted for potential risks associated with those effects."[44] The Tribunal concluded that while Claimant's plan for the supply of water to the project was feasible, it had not "accounted for the potential extra costs associated with having to implement an aquifer injection system to mitigate possible drawdown effects into Afghanistan."[45] Since the risk of this happening was "minimal," the Tribunal agreed with Claimant that a buyer in November 2011 would not have considered this effect in the value of the Reko Diq project.[46]

(vi) Although Claimant Had a Feasible Plan for Dealing With the Security Concerns, an Adjustment Was Warranted

Whereas Respondent alleged that Claimant was planning to build a mine in "one of the most dangerous places in the world,"[47] Claimant argued that its Feasibility Study adequately considered the "relevant security risks, including those associated with transporting the slurry concentrate by pipeline to the port of Gwadar."[48] In assessing security concerns, the Tribunal first addressed "Claimant's security plan for the project's central facilities" and then turned to the "security plan for the off-site facilities and, in particular, the slurry concentrate pipeline."[49] It found, *first*, that Claimant's security plans for the project's central facilities were sufficiently adequate for a project at the development stage of Reko Diq.[50] It also found, *second*, that Claimant's estimated budget covered security threats, including an attack on the slurry concentrate pipeline.[51] The Tribunal additionally sought to establish the reduction in value of the project as a result of security risks – whether Claimant's expert had adequately quantified residual security-related risks in the prepared valuation. It found that although Claimant had adopted a "reasonably reliable [] indicator for the risks," it did not come up with a rate that "fully capture[d] the[] risks" caused by political violence.[52] Consequently, the Tribunal concluded that an "additional amount of USD 711.5 million ha[d] to be deducted from the value of Claimant's investment." [53]

(vii) Claimant Had a Feasible Plan for Complying With Environmental Regulations and Obtaining a Social License, but a Deduction Was Justified

The Tribunal next considered whether Claimant adequately addressed environmental and social management issues in the Environmental and Social Impact Assessment (**ESIA**).[54] To do this, the Tribunal considered, *inter alia*, Respondent's arguments raised on the impacts of the project on air quality, sea water quality and mine closure.[55] However, Respondent failed to convince the Tribunal that any alleged environmental nonconformities in the ESIA would generate significant work and/or costs beyond the cost estimates already included in the Feasibility Study.[56] Similarly, the Tribunal found that Claimant had adequately addressed the social impacts of the project in the ESIA, and there was "no basis to assume that a lender would have considered the cost that Claimant contemplated to spend on [] community programs it had described insufficient."[57] Relatedly, the Tribunal assessed whether Claimant's expert "adequately accounted for the costs and risks associated with the environmental and social impacts of the project."[58] It found that since the cost estimate of the Feasibility Study did not include the cost of additional community initiatives submitted to the Government of Balochistan in 2010, such a cost estimate had to be deducted from Claimant's valuation model.[59]

(viii) Claimant Had a Feasible Plan for Obtaining Permits for the Project, and Claimant's Valuation Model Adequately Incorporated Delays

Claimant successfully established that the delays modeled in its valuation accounted for potential difficulties in obtaining relevant permits and/or land rights in a manner that would have been considered sufficient by a buyer as of the valuation date. Notably, the Tribunal did not require Claimant to "show that it already 'had the necessary permits'"

in order to apply the modern DCF model.[60] Rather, it assessed whether Claimant had a feasible plan for the acquisition of land, which Respondent had argued would "necessarily [] precede the construction of the pipeline."[61] It found that no concerns were raised by the government that it "might be difficult or a lengthy process to obtain the land required for building a pipeline and/or an access road"[62] and, further, that there existed "no basis to assume that [the] timing, [and] delays modeled by [Claimant's expert] would have been considered insufficient by a buyer as of the valuation date."[63] Respondent's argument that Claimant "failed to identify relevant permits or approvals" and that "a buyer would have expected Claimant to have obtained or applied for any additional permits or approvals as of the valuation date" were dismissed by the Tribunal.[64] Although it was not guaranteed that Claimant would not have faced permitting issues, the "delays modeled by [Claimant's expert] in his valuation would have been considered sufficient by a buyer as of the valuation date."[65]

(ix) Claimant Could Have Obtained the Necessary Funding for the Project, and Claimant's Valuation Model Adequately Accounted for Financing Risks

Lastly, Respondent argued that the Reko Diq project was not financially feasible from a bankability perspective and that a decision to fund the project would have required Claimant's owners to compromise their "internal policies and risk their market reputation."[66] Thus, the Tribunal assessed whether Claimant had established that (i) "its owners were able and willing to provide the contemplated amount of [] equity funding to the project," and (ii) "it could have financed the remaining amount of [] the project costs through limited recourse funding to be obtained from third parties."[67] The Tribunal

determined not only that Claimant could have obtained necessary funding both from its owners and third parties, but also that Claimant's expert had "adequately accounted for the [risks] associated with financing, including [] uncertainty as to the precise identity of the lenders and the terms at which they would provide funding to the project."[68]

D. Value of Claimant's Investment

After assessing the risks and issues that could impact the feasibility and profitability of the project, the Tribunal turned to assessing whether Claimant's expert had properly accounted for all relevant systematic and asymmetric risks of the project in his projection of future cash flows.[69] The Tribunal also recalled CIMVal's letter that "reasonable, and perhaps conservative assumptions" could be required to control for uncertainties in the modern DCF approach.[70]

First, the Tribunal assessed whether Claimant's expert appropriately accounted for the systematic risk of fluctuations in the prices for copper, gold and oil. Respondent had argued that Claimant's expert employed "'inordinately speculative' projections of futures prices."[71] The Tribunal found that it was "reasonable to conclude that a buyer would have factored in the possibility that not all of the systematic risk associated with the development of prices over the [] life of the mine [would be] fully captured in the available market data and quotations going up to ten years into the future and the extrapolation of such data..." [72] Thus, the Tribunal concluded that it would be likely that a buyer would have "assigned a price to assuming this long-term risk by reducing its expectation of the cash flows that the Reko Diq project would generate over the life of the mine."[73]

Second, the Tribunal assessed whether Claimant's expert appropriately accounted for the risks of increases in capital and operating expenditures (other than oil). It was undisputed that Claimant's expert had made "significant adjustments to the capital cost estimates included in the Feasibility Study and the Expansion Pre-Feasibility Study."[74] This included "reducing the value of Claimant's investment by 1.5% or USD 130 million," which was to be deducted from the amount of compensation to which Claimant would have been entitled.[75] As a result, the Tribunal rejected the modeling variability calculations made by Respondent's expert because it found it "incorrect to apply the distribution mean to [Claimant's expert's] cost estimate which ha[d] already been adjusted to account for the same cost increases that are also reflected in the distribution mean."[76] The Tribunal concluded that "no further reduction [was] warranted to account for potential increases in capital costs or operating costs of the project."[77]

Third, the Tribunal considered whether asymmetric risks affecting the project, particularly country-related risks, had been appropriately accounted for in Claimant's expert's valuation. Claimant had identified most of these risks in Claimant's residual risk register, which included, *inter alia*, "many country-specific risks during both the construction and operation phases of the project," as well as "corruption, armed conflict, delays due to inexperienced workforces and government authorities, logistics disruptions, community relations impacts, and changing regulations."[78] Neither Respondent nor its expert offered any specific country-related risks which were not already included in Claimant's risk register or which should have been quantified and included by Claimant's expert in the valuation model. Subsequently, the Tribunal agreed with Claimant that "it is generally appropriate to value the Reko Diq project based on the concept of certainty-equivalent cash flows" and that "the asymmetric risks affecting the project, including country-related risks, should not be reflected in the discount rate as they would be in a traditional DCF calculation but rather in *individual risk adjustments made to the cash*

flows themselves."[79] After assessing the modeling adjustments for three categories – namely (i) events that could lead to early termination of the project, (ii) events that could cause project start-up delays before construction, and (iii) risks that could cause temporary interruption of operations – the Tribunal concluded that no other adjustments were needed to determine the impact of business interruptions.[80]

Fourth, following arguments made by Respondent's expert, the Tribunal also assessed whether the implied discount rate used by Claimant's expert was too low. Claimant's expert argued, and the Tribunal agreed, that "the implied discount rate calculated by Respondent's expert did not take into account all of the risk adjustments he had made."[81] Since neither expert provided the Tribunal with a number that could serve as a risk premium reflecting all of the asymmetric risk adjustments made by Claimant's expert, the Tribunal was unable to draw comparisons with what could have been considered an "adequate country risk premium in a traditional DCF calculation."[82] The Tribunal thus expressed no opinion as to the "disagreement between the experts regarding an appropriate discount rate and/or country risk premium for a traditional DCF valuation of Claimant's investment."[83]

Fifth, the Tribunal also reviewed the comparison drawn by Respondent's experts between Claimant's expert's model and the revenues and costs estimated in the Expansion Pre-Feasibility Study (made for the purposes of a traditional DCF calculation).[84] Respondent had raised this argument to support their proposition that Claimant's expert did not apply an appropriate discount rate and that the risk adjustment made by Claimant's expert was insignificant.[85] The Tribunal rejected this argument and agreed with Claimant and its expert that applying a risk-adjusted discount rate would amount to "double-counting the same risks," which would be "contrary to the modern DCF valuation approach."[86] Thus, the Tribunal concluded that the "comparison to the traditional DCF calculation made in the Expansion Pre-Feasibility Study does not warrant the conclusion that [Claimant's expert] did not make significant risk adjustments to the cash flows in his model."[87]

Lastly, the Tribunal looked at whether Claimant's expert appropriately discounted the cash flows at the risk-free rate. The Tribunal recalled prior adjustments regarding the systematic risk of prices for copper, gold and oil and for capital cost variability, but did not note any basis for applying further residual risk adjustments (nor did Respondent provide any).[88] Moreover, since Respondent's expert did not challenge the risk-free rate applied by Claimant's expert, the Tribunal considered it "undisputed that the risk-free rate selected by [Claimant's expert] was appropriate to make the necessary adjustment for the time value of money."[89]

In sum, under the modern DCF model, the Tribunal found that the total value of Claimant's investment amounted to US$4.087 million.[90] This value was calculated by taking the amount of Claimant's damages (US$8.490 million) and subtracting from it the amount allocated to risks and issues raised by Respondent regarding the feasibility of the project (US$1,843 million), and further deductions to account for the systematic and asymmetric risks affecting the project (US$2.560 million).[91]

E. Verification of the Tribunal's Conclusion on the Value of Claimant's Investment

Interestingly, the Tribunal also sought to verify whether the conclusion it reached based on the modern DCF was reconcilable with results of other valuations. However, the Tribunal lacked a valuation based on a traditional DCF analysis (since neither Party had conducted such analysis for the purposes of the arbitration using inputs as of the valuation date).[92] Thus, the Tribunal employed for verification purposes (i) Claimant's update of the DCF calculation

from the Expansion Pre-Feasibility Study, and (ii) a valuation performed by Respondent's expert, which was based on past transactions by which Claimant's owners acquired Claimant in 2006.[93] After considering these differing approaches, the Tribunal decided the results yielded by the other valuation methods did not warrant any adjustments to the conclusion on valuation the Tribunal had reached on the basis of the modern DCF model.[94] The difference between the modern DCF valuation and the indication of value yielded by the updated calculation was, *inter alia*, a consequen Pakista ce of the fact that the "calculation in the Expansion Pre-Feasibility Study was not intended to capture the value of the project as reflected in the cash flows to be generated over the life of a mine."[95] Likewise, the Tribunal found "reasonable explanation" for the deviation between the values yielded by the modern DCF model and the model employed by Claimant's expert, which did not "account for any increase in value created by Claimant's work after 2006."[96] Thus, the role of backward-looking approaches (i.e., the market-based approach and "amount invested" or "sunk cost" approach) in the verification of forward-looking models remains to be seen.

F. Pre- and Post-award Interest

Pursuant to the principle of "full reparation" under customary international law, Claimant requested pre- and post-award compound interest to be calculated at either "(i) Respondent's short-term, unsecured, dollar-denominated borrowing rate, which corresponds to an annualized compound rate of 4%"; or (ii) "'another conservative rate' such as the US prime rate plus two percentage points, which corresponds to an annualized compound rate of 5.6%."[97] In contrast, pursuant to Article 7(3) of the BIT, Respondent argued for simple interest at a "risk-free rate such as [that used for] the one-month US Treasury bills."[98] The Tribunal rejected Respondent's argument, holding that "compound interest more adequately reflects economic reality and thus the loss that the Claimant has in fact incurred as a result of Respondent's Treaty breaches."[99] Consequently, the Tribunal awarded Claimant interest at a rate "corresponding to the US Prime Rate plus 1 percentage point, compounded annually, which [would] accrue[] on the amount of compensation determined by the Tribunal."[100]

[1] *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, ICSID Case No. ARB/12/1, Award, July 12, 2019, ¶ 272.

[2] The Parties agreed that "market value" represents "the cash-equivalent amount a willing buyer would pay a willing seller to purchase the asset at the Valuation Date, both with reasonable knowledge of the facts and circumstances surrounding the asset and neither being under any compulsion to transact." Award ¶ 274.

[3] Award ¶ 273.

[4] Award ¶ 278.

[5] Award ¶ 112.

[6] Award ¶ 281.

[7] Award ¶ 284.

[8] Award ¶ 288.

[9] *Id.*

[10] Award ¶ 290.

[11] Award ¶ 307.

[12] Specifically, the Tribunal considered cases such as *Gold Reserve v. Venezuela, Crystallex v. Venezuela, Rusoro v. Venezuela*, and *Khan Resources v. Mongolia*. The Tribunal also considered *Bear Creek v. Peru* and *Vivendi v. Argentina*. *Bear Creek v. Peru* was the only case in which a modern DCF approach was presented by one of the parties as a comparison to the traditional DCF calculation.

[13] Award ¶ 330.

[14] *Id.*

[15] Award ¶ 205.

[16] Award ¶¶ 206, 258.

[17] Award ¶ 332.

[18] *Id.*

[19] Award ¶ 333.

[20] Award ¶ 334.

[21] Award ¶ 335.

[22] Award ¶ 340.

[23] Award ¶ 345.

[24] Award ¶ 355.

[25] Award ¶ 356.

[26] Award ¶ 113.

[27] Award ¶ 417.

[28] Award ¶ 459.

[29] Award ¶ 460.

[30] Award ¶ 480.

[31] Award ¶ 501.

[32] Award ¶ 531.

[33] Award ¶ 116.

[34] Award ¶ 578, 610.

[35] Award ¶ 648.

[36] Award ¶ 652.

[37] Award ¶ 701.

[38] Award ¶ 739.

[39] Award ¶ 118.

[40] Award ¶ 751.

[41] Award ¶ 763.

[42] Award ¶ 784.

[43] Award ¶ 807.

[44] Award ¶ 808.

[45] Award ¶ 829.

[46] Award ¶ 828.

[47] Award ¶ 851.

[48] Award ¶ 830.

[49] Award ¶ 876.

[50] *Id.*

[51] Award ¶ 928-929.

[52] Award ¶ 955.

[53] Award ¶ 957.

[54] Award ¶ 1005.

[55] Award ¶ 1051, 1067, 1081, 1103.

[56] Award ¶ 1119.

[57] Award ¶ 1158.

[58] Award ¶ 1163.

[59] Award ¶ 1177-1178.

[60] Award ¶ 1208-1209.

[61] Award ¶ 1211.

[62] Award ¶ 1237.

[63] Award ¶ 1244.

[64] Award ¶ 11266.

[65] Award ¶ 1280.

[66] Award ¶ 1302.

[67] Award ¶ 1350.

[68] Award ¶ 1420.

[69] Award ¶ 1423. Systematic risks include, for example, the fluctuation of prices for gold, copper and oil, and asymmetric risks include risk of an early shutdown or delays in commencing construction and operations of the mine.

[70] Award ¶¶ 1476-1477.

[71] Award ¶ 123.

[72] Award ¶ 1521.

[73] *Id.*

[74] Award ¶ 1536.

[75] Award ¶ 1539.

[76] Award ¶ 1543.

[77] Award ¶ 1544.

[78] Award ¶ 1546.

[79] Award ¶ 1557 (emphasis added).

[80] Award ¶¶ 1567.

[81] Award ¶¶ 1572, 1576.

[82] Award ¶ 1577.

[83] *Id.*

[84] Award ¶ 1578.

[85] *Id.*

[86] Award ¶ 1593.

[87] Award ¶ 1594.

[88] Award ¶ 1597.

[89] Award ¶ 1599.

[90] Award ¶ 1601.

[91] Award ¶ 1600.

[92] Award ¶ 1643.

[93] Award ¶ 1644.

[94] Award ¶ 1740.

[95] Award ¶ 1693.

[96] Award ¶ 1739.

[97] Award ¶ 106.

[98] Award ¶ 128.

[99] Award ¶ 1808.

[100] *Id.*

ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/30

Date of the Award
March 8, 2019

Decision on Rectification
August 29, 2019

The Parties
ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. (**Claimants**), Bolivarian Republic of Venezuela (**Venezuela or Respondent**). Claimants and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties**."

Sector
Oil

Applicable Law
Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela signed on October 22, 1991 (the **Netherlands-Venezuela BIT** or the **BIT**)[2]

Members of the Tribunal
Mr. Eduardo Zuelta (president, appointed by the Chairman of the Administrative Council), Mr. L. Yves Fortier (Claimants' appointee) and Professor Andreas Bucher (appointed by the Chairman of the Administrative Council)[3]

Background

This dispute concerns Claimants' interests in two extra-heavy oil projects in the Orinoco Oil Belt in Venezuela – the Petrozuata Project and the Hamaca Project – and an offshore project to extract light to medium crude oil, the Corocoro Project.

The Petrozuata Project was conducted through the Petrozuata Association, which had the rights to engage in the exploration, development, production, exploitation, transportation and upgrading of extra-heavy crude oil, and to market the resulting crude oil products in the Zuata area of the Orinoco Oil Belt. Conoco Phillips held a 50.1 percent interest in the Petrozuata Project, with the remaining 49.9 percent held by a, Petróleos de Venezuela, S.A., the Venezuelan national oil company (**PdVSA**) affiliate.

The Hamaca Project was conducted through the Hamaca Association, which had the rights to engage in the exploration, development, production, exploitation, blending, industrialization, transportation, refining and upgrading, and commercialization of extra-heavy crude oil, and the transporting and using or disposing of by-products in the Hamaca area of the Orinoco Oil Belt. ConocoPhillips owned a 40 percent interest in the Hamaca Project. The two other participants in the project were a PdVSA subsidiary and Chevron, each of which held a 30 percent interest.

The Corocoro Project was one of eight joint ventures for the exploration and production of crude oil under profit-sharing agreements. The project was conducted through the Corocoro Development Consortium, which had the rights to explore, evaluate, develop and exploit commercial hydrocarbons reservoirs within the western Gulf of Paria, including handling production from such reservoirs and transportation. ConocoPhillips held a 32.2075 percent interest in the project. A PdVSA subsidiary had a 35 percent interest in the project. Two other investors held the remaining interest.

The Petrozuata and Hamaca Projects were initially set up through U.S. companies in 1995 and 1997, respectively, and the Corocoro Project was undertaken initially by Conoco Venezuela BV (a Dutch company) in 1996, but then transferred to Conoco Venezuela CA (a Venezuelan company) in 1999. However, Claimants were subsequently incorporated in 2005 and 2006 and took ownership of the projects as follows:

- ConocoPhillips Petrozuata B.V. was incorporated on July 26, 2005, and the ownership interests in the Petrozuata Project were transferred to it on July 27, 2005.
- ConocoPhillips Hamaca B.V. was incorporated on July 26, 2005, and the ownership interests in the Hamaca Project were transferred to it on August 11, 2005.
- ConocoPhillips Gulf of Paria B.V. was incorporated on July 17, 2006, and the ownership interests in the Corocoro Project were transferred to it on September 22, 2006.

Starting in April 2005, Venezuela began enacting new taxes and royalty rates concerning extra-heavy oil-producing companies. These included:

- April 12, 2005: The Minister of Energy and Mines declared operating service agreements illegal and initiated the “migration” of those agreements to new mixed companies under the 2001 Hydrocarbons Law.
- April 26, 2005: Vice Minister Mommer announced to ConocoPhillips that enhanced 30 percent royalty rates would be applied to production of between 120,000 and 145,000 barrels per day.
- May 16, 2006: A 33⅓ percent extraction tax was enacted, effective May 24, 2006.
- August 29, 2006: The tax law was amended raising the income tax rate for extra-heavy oil-producing companies from 34 percent to 50 percent, effective January 1, 2007.
- January 8, 2007: President Chavez announced that all projects operating outside the framework of the 2001 Hydrocarbons Law (including the

Petrozuata, Hamaca and Corocoro Projects) would be nationalized.

- February 26, 2007: Decree Law No. 5.2000 was enacted, which called for the transformation of all oil associations into mixed companies.
- May 1, 2007: PdVSA took physical control of the Petrozuata, Hamaca and Corocoro Projects.
- June 26, 2007: Venezuela took ConocoPhillips' interests in the Petrozuata, Hamaca and Corocoro Projects.

On November 2, 2007, Claimants filed a request for arbitration before ICSID under (i) the Investment Law and (ii) the Netherlands-Venezuela BIT.

Jurisdiction and Liability

On September 3, 2013, the Tribunal issued its Decision on Jurisdiction and the Merits.[4] It found unanimously that it lacked jurisdiction under the Investment Law and accordingly dismissed the claims by ConocoPhillips Company.[5] It also found unanimously that it had jurisdiction under the BIT over Claimants' claims concerning (i) the increase in the income tax rate which came into effect on January 1, 2007, and the expropriation or migration of Claimants' investments; and (ii) the claims by ConocoPhillips Petrozuata BV and ConocoPhillips Gulf of Paria BV regarding the increase in the extraction tax on May 24, 2006.[6]

The Tribunal rejected Claimants' Article 3 (fair and equitable treatment) claims.[7] But it found, by majority, that Venezuela breached Article 6(c) by failing to negotiate with Claimants in good faith on the basis of market value for the compensation due to Claimants for Venezuela's taking of its assets.[8] It also decided that the date of valuation of the ConocoPhillips assets should be the date of the Award. All other questions, including those concerning damages and costs, were reserved for future determination in a separate quantum phase.

Quantum

A. Procedural History Concerning Quantum

i. The First Phase on Quantum

The Tribunal's First Phase on Quantum concerned, *inter alia*:

(i) the scope of the Tribunal's finding on Article 6(c) of the BIT and the outcome of the Claimants' claim for a declaration that the Respondent breached Article 6 of the BIT; (ii) the Respondent's Third Application for Reconsideration; (iii) the *misrepresentation* allegation; [and] (iv) the relevance of the *compensation formulas*...[9]

The First Phase on Quantum included a hearing from August 15 to 19, 2016.

Following the hearing, and after consulting the Parties, the Tribunal issued Procedural Order No. 4 and ordered the Parties to provide joint consolidated expert reports concerning (i) the production capacities of the three projects and (ii) the amount of damages resulting from the expropriation of the three projects (including the basis of a jointly agreed structure).

The Tribunal then issued its interim decision on January 17, 2017. In that decision, the Tribunal (i) rejected Respondent's Third Application for Reconsideration; (ii) dismissed Respondent's claim based on Claimants' alleged misrepresentations; and (iii) declared that Venezuela breached its Article 6 BIT obligation when it unlawfully expropriated Claimants' investments in the three projects.[10]

ii Second Phase on Quantum

Following its 2017 Interim Decision, the Tribunal held a hearing on the Second Phase

on Quantum from February 21 to 25, 2017, and March 27 to 31, 2017.

Prior to the March 2017 hearing, the Parties provided the Tribunal (upon request) with tables concerning the three projects, including the annual production figures by year.[11] The tables also included information with respect to the projects' operating expenses (**OPEX**) and capital expenditures (**CAPEX**).[12] Additionally, the Parties provided tables reflecting the impact of the windfall profit tax, enacted on April 15, 2008, on each project.[13]

Following the March hearing, the Tribunal asked Respondent to submit copies of "the invoices of the [commercial crude oil] sold between 2009 and 2015, together with monthly lists of the quantities of oil sold and loaded on vessels for the purpose of exportation."[14]

In April 2017, the Tribunal directed the valuation experts to confer and seek to narrow the gaps between their respective positions related to discount rates in general, and specifically regarding country risk.[15] However, the experts were unable to narrow the gap between their respective views.[16]

On April 27, 2017, the Tribunal wrote to the Parties explaining that their "experts had made various assumptions and assertions that were either wrong, not cross referenced to evidence in the record, or simply not supported by sufficient evidence."[17]

The Tribunal further requested that the Parties submit a "jointly prepared assessment" of the actual production of the projects and an assessment of the associated costs by May 29, 2017 (though this date was ultimately extended to June 2, 2017).[18]

On June 2, 2017, the Parties submitted two sets of documents, containing (i) an assessment of production reported by Respondent for the three projects, commented on by Respondent and Claimants, and (ii) Respondent's estimated *ex post* OPEX and CAPEX for each project, also commented on by Respondent and Claimants (**Cost Estimations**).[19]

The Tribunal then submitted to the Parties a list of questions on June 8 and 14, 2017.[20]

Following these supplementary questions, the Tribunal fixed a final hearing to be held from September 19 to 21, 2017.[21] The aim of the final hearing was to hear and address the Parties' answers to the Tribunal's questions and the Parties' further clarifications.

B. Applicable Law Governing Quantum

The Tribunal found that the applicable law governing compensation was the BIT, in particular Article 9. That article grants the Tribunal jurisdiction to determine the amount of compensation,[22] but also provides that the arbitral award should be based on five sources of law: "the law of the Contracting Party concerned; the provisions of the [BIT] and other relevant Agreements between the Contracting Parties; the provisions of special agreements relating to the investments; the general principles of international law; [and] such rules of law as may be agreed by the parties to the dispute."[23]

The Tribunal found that Article 9(5) of the BIT did not provide any hierarchy for how these sources should be applied.[24] But it explained that, as a general matter, where a dispute arises under international law, international law must prevail over domestic law and "a State may not invoke its internal law to extract itself from an international law obligation."[25]

The Tribunal then assessed the impact of the compensation provisions of the Petrozuata and Hamaca Association Agreements on Claimants' damage claims. The Parties' disagreement centered on whether these Association Agreements could be used to limit Venezuela's liability under international law for its expropriation of these projects – even though Venezuela was not a party to these agreements.

The Tribunal found that in accordance with Article 31, §3(c) of the Vienna Convention of the Law of Treaties, the interpretation of the BIT has to take into account "any relevant rules of international law applicable in the relations between the parties."[26] Therefore, while the Tribunal found it must be mindful of the BIT's "special purpose as a Treaty promoting foreign investments," it could not apply the BIT in a vacuum.[27] Consequently, the Association Agreements were relevant in calculating the damages owed to Claimants.

*i. **Compensation Provisions of the Association Agreements***

The Tribunal reflected the debate between the Parties on whether the Association Agreements were "based on the implicit but nevertheless fundamental principle that the host State's ability to capture extraordinary profits must be preserved ... ."[28] It noted that, in marked difference to older state contracts, the Association Agreements did not contain so-called 'stabilization clauses' whereby the state agreed not to interfere with the legal and economic characteristics of the contract. Nevertheless, the compensation provisions in the Association Agreements grant compensation if the state takes a "Discriminatory Action" that causes a significant loss to the foreign investor.[29]

However, the Tribunal rejected Respondent's position that the compensation provisions should govern the damages owed to Claimants.[30] The Tribunal explained that it was not seized with a claim concerning the provisions of the Association Agreements because Claimants' request for relief was "based on a claim that the Respondent breached Article 6 of the BIT."[31] The Tribunal also found flaws in Respondent's case including that, under the Association Agreements, a "Discriminatory Action should follow a 'Development Decision,'" which has nothing in common with an expropriation;[32] that the Association Agreements were effectively terminated on June 26, 2007, when Venezuela expropriated Claimants' investment;[33] and that "if the Claimants' claim for compensation was governed by the compensation provisions of the Association Agreements, it would be covered by the arbitration clauses contained therein."[34]

Nonetheless, the Tribunal found that the Association Agreements were not "irrelevant for the Tribunal's ruling on the consequences of the expropriation that breached Article 6(c) of the BIT. [35] The Tribunal considered that the agreements formed part of the "bundle of rights" which were "taken" from Claimants when their investments were expropriated.[36]

The Tribunal explained that because "full compensation" could not represent more than compensation of the rights and assets held by Claimants, the Association Agreements limited Claimants' potential compensation.[37] This was necessary to ensure that Claimants' damages would not "cover more than what the Claimants were entitled to if there had been no expropriation."[38]

In doing so, the Tribunal affirmed the *Burlington* tribunal's analysis that "[it] must assume that [a claimant] holds the rights that made up the expropriated assets and that those rights are respected."[39] The Tribunal further explained that this did not mean that it was enforcing a contract claim, but rather that the Tribunal was acknowledging that the value of an expropriated asset "consists of a bundle of rights allowing [a claimant] to obtain future revenues."[40] As a result, the Association Agreements and their compensation provisions "may have an impact on the value of the taking and thus the amount of damages."[41]

ii. Meaning of "Full Reparation"

To determine the standard of compensation, the Tribunal relied heavily on the precedent established by the Permanent Court of International Justice in *Chorzów Factory*. The Tribunal considered it necessary to evaluate how to distinguish compensation for a lawful expropriation and an unlawful expropriation. It explained that, pursuant to the *Chorzów* judgment, an "investor that suffered an expropriation that was otherwise 'lawful' (except for the nonpayment of compensation) is not entitled to [a] claim for more than the payment by the host State of such compensation reflecting the market value of the investment at the moment of the expropriation, plus interest to the day of payment."[42] At the same time, the Tribunal considered that – pursuant to *Chorzów* – it would be improper to award the same compensation if a breach of Article 6 of the BIT had occurred and the host state could obtain all the benefits in the period between the taking and the rendering of this Award.[43] This would allow Respondent to acquire "through the expropriation, profits available to the Claimants through the Projects."[44] The Tribunal found that "a damages award that returns the plaintiff to its economic position at the date of the injury, but leaves the defendant with a gain as a result of his action may not be appropriate and not deter future unlawful acts."[45]

The Tribunal therefore endeavored to find an appropriate middle ground between an *ex ante* and an *ex post* valuation.[46] It ultimately decided to apply an *ex post* approach based on actual figures where *ex ante* valuation figures had proved incorrect during the projects' operation. But it also relied on *ex ante* valuations when the *ex post* information was "neither available nor reliable."[47] Additionally, the Tribunal noted, when weighing the evidence submitted by the Parties, that in some cases the projects' partners' assumptions before the expropriation were an appropriate reference point, especially where such assumptions were prepared in cooperation among all partners to the projects.[48]

C. Issues Relating to Evidence

In evaluating the Parties' damage calculations, the Tribunal pointed out that – in accordance with Article 48(3) of the ICSID Convention and Arbitration Rule 47(1)(i) – it must state the reasons upon which its Award is based. It highlighted that "the opinion of experts must be capable of being translated into reasons provided by the Tribunal" and that such

reasons could not be based "on mathematical formulae not accompanied by explanations serving as evidence or reasons of law."[49]

The Tribunal therefore found it necessary in a number of occurrences "to simply dismiss allegations that [were] not supported by sufficient evidence" or "to proceed with its own estimates."[50]

The Tribunal engaged in an extensive analysis of the evidence presented with respect to (i) volumes of production (divided into the three main sections of upstream, upgrading and downstream);[51] (ii) costs (capital and operating expenses);[52] (iii) prices and revenues;[53] (iv) royalties and taxes (including the "windfall profit tax");[54] (v) dividends and compensation;[55] (vi) interest;[56] (vii) discount rate (including general country risk assumptions and risk of expropriation and taxation);[57] (vii) debt repayment;[58] and (ix) avoidance of double recovery in view of the award rendered under ICC rules on April 18, 2018, and a respective settlement agreement submitted to the Tribunal by the Parties on August 20 and 21, 2018.[59]

In addition to its assessment of the conclusions reached by the Parties' experts, the Tribunal found the Parties' presentation of evidence with respect to the costs associated with the Petrozuata and Hamaca Projects to be "deplorable and surprising."[60] It considered that the record was "grossly incomplete"[61] and that the key witness presented by Respondent could not offer the Tribunal information based on personal knowledge and had provided the Tribunal with about 5,000 pages of cost documents, which were neither organized nor indexed.[62]

The Tribunal explained that its preference would have been "to rely on evidence of actual costs" as opposed to projections when determining the total amount of costs concerning, *inter alia*, drilling at the project sites.[63] Where precise records were submitted, the Tribunal relied on those. For example, in assessing Claimants' historical loss, it looked at the actual oil prices, which were submitted by Respondent.[64]

D. Issues Related to Modeling

i. Modeling the "But For" World

Of particular relevance in valuing Claimants' damage was the impact of the "windfall profit tax" – which was introduced in Venezuela in 2008 and amended several times since – on the "but for" world used in the experts' damage models. The parties disagreed on whether it

was appropriate to include this tax in the "but for" world, as it was enacted by Venezuela after the date of expropriation.

The Tribunal found that modifications in the tax regime based on Respondent's sovereign power should be included in the "but for" analysis of the projects, subject to potential compensation under the appropriate provisions of the Association Agreements.[65] While the Tribunal agreed with Claimants that in the context of an unlawful expropriation, "a date-of-award valuation must ensure that ... any increase in value since the date of expropriation is retained by the injured investor and not diverted to the breaching State," [66] this did not mean that the "windfall profit tax" should be ignored. Instead, the Tribunal found that since the time of negotiation of the Association Agreements, it was settled that the Government remained completely autonomous in the exercise of its sovereign power, including its power to fix the tax regime of the partners in the Association Agreements, subject only to certain conditions and limits in the compensation provisions.[67]

Moreover, the Tribunal found that it would be incorrect to permit Claimant to "claim the benefit of increasing oil prices after the expropriation while refusing the State's increase of taxes, which may trigger the compensation mechanism, agreed between all partners specifically for such a situation."[68]

ii. Modeling the Discount Rate

The Tribunal took particular issue with the experts' presentation of the appropriate discount rate. It explained that it "would have preferred to be faced with proposals presented clearly by the experts in such a way that [it] could reach a decision without becoming involved too deeply into the field of economics which, after all, should be the experts' foremost area of expertise," but that it had to accept that such a guided choice was "impossible when the experts' proposed discount rates are, respectively, 11.6% and 27.7%, a difference of more than 16%."[69]

The Tribunal recalled that it had tried to direct the experts to confer and to narrow the gaps; however, such efforts were unsuccessful.[70] The Tribunal therefore decided to make its own adjustments even though "some experts may consider [them] to be a deviation from economic discipline."[71] The Tribunal then engaged in its own analysis of the factors affecting the discount rate, taking into account U.S. market assumptions, discount rates on foreign markets, general country risk assumptions, the risk of expropriation and taxation, the risk inherent in the credit rating of debt, considerations of a willing buyer, costs of debt, and the projects' inherent discount rate.[72] Based on the cost of capital (1.9 percent (reflecting a risk free rate) + 5.5 percent (reflecting the industry risk rate))[73] and adding the respective components, the discount rate became between 17.15 percent and 17.40 percent, a difference the Tribunal settled – based on its margin of discretion – at 17.25 percent.[74]

E. Conclusion on Damages and Interest

Based on the reasons stated, the Tribunal decided that Respondent should pay as compensation for the expropriation in breach of the BIT US$3,386,079,057 to ConocoPhillips Petrozuata B.V., US$4,498,085,150 to ConocoPhillips Hamaca B.V. and US$ 562,140,959 to ConocoPhillips Gulf of Paria B.V.[75] In addition, Respondent was ordered to pay US$286,740,989 to ConocoPhillips Petrozuata B.V. based on the compensation provisions of the Petrozuata Association Agreement.[76]

The amounts awarded were to be paid by Respondent not later than 60 days after the issuance of the Award. After that, interest on the amounts would accrue at a rate of 5.5 percent compounded annually.[77] However, with respect to the amount payable to ConocoPhillips Petrozuata B.V. based on the compensation provisions of the Petrozuata Association Agreement, simple interest until the date of full and final payment at 12-month LIBOR, or any other comparable rate in case LIBOR should be discontinued in the future, was to be paid.[78]

F. Legal Fees and Costs

The Tribunal closely examined the Parties' requests for compensation concerning their respective legal fees and costs. It assessed three principles supporting Claimants' submission that Venezuela should reimburse all of Claimants' costs:[79] (i) that costs follow the event,[80] (ii) the concept of "full reparation" from *Chorzów*[81] and (iii) that Venezuela engaged in "dilatory and obstructionist tactics."[82]

The Tribunal considered that, notwithstanding the high costs and fees associated with the arbitration, it had "no reason to inquire about their substance in light of the long duration of this arbitral proceeding, the size of the record and the complexity of a great number of questions raised."[83]

It found that the concepts of "costs follow the event" and "full reparation" did not mean that Claimants – merely by receiving a damage award in their favor – were entitled to a claim for all their costs. In particular, it found that the ICSID fees and expenses were to be determined irrespective of the amounts claimed and without evaluation of the potential success or *prima facie* chance for prevailing before the Tribunal.[84] The Tribunal therefore found that these costs were to be evenly divided by the Parties.[85]

However, it did find that, in keeping with both the principles of "costs follow the event" and "full reparation," Claimants' success on their principle claim meant that it was proper to order Respondent to bear a significant part of Claimants' legal fees and costs. That said, Claimants were not successful on all claims – in particular, the Tribunal's 2013 Decision on Jurisdiction and the Merits dismissed Claimants' claims concerning ConocoPhillips Company, and that claimant "disappeared" from the proceeding.

The Tribunal also assessed the value of the Award as compared to the amount claimed by Claimants. Seeing as it had awarded Claimants approximately 40 percent of their claimed damages, the Tribunal found it was proper to have Respondent pay 40 percent of Claimants' legal fees (less the reduction of expenses related to the ConocoPhillips Company claim).[86]

Decision on Rectification

Following the Award, Venezuela raised three "clerical and arithmetical issues emerging from the Tribunal's calculations relating to the windfall profit tax and ConocoPhillips Petrozuata B.V.'s compensation under Section 9.07 of the Petrozuata Association Agreement."[87] Two of the three errors were not contested by Claimants.[88]

The contested alleged error concerned one of the Tribunal's tables regarding compensation to be provided with respect to the Petrozuata Project. According to Venezuela, the Tribunal granted Claimants compensation for the entirety of the project and not merely 50.1 percent of the project (corresponding to ConocoPhillips Petrozuata B.V.'s interest in the Petrozuata Project).

The Tribunal concluded that there were arithmetical errors in the table[89] It also noted an additional calculation error with respect to the "windfall profit tax". As a result, the Tribunal modified the numbers and corrected the two errors.[90] Consequently, the corrected damages awarded to Claimants for the breaches of the BIT were US$3,370,955,417 (ConocoPhillips Petrozuata B.V.), US$4,443,122,885 (ConocoPhillips Hamaca B.V.) and US$ 552,059,091 (ConocoPhillips Gulf of Paria B.V.).[91] In addition, the amount awarded to ConocoPhillips Petrozuata B.V. based on the compensation provision of the Petrozuata Association Agreement was corrected to US$139,807,899.[92]

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1 ConocoPhillips Company was initially a claimant to the arbitration; however, the Tribunal ultimately concluded it lacked jurisdiction over ConocoPhillips Company when it dismissed Claimants' claims arising under the Investment Law.

2 Claimants initially also brought claims under the Venezuelan Law on the Promotion and Protection of Investments (Decreto con Rango y Fuerza de Ley de Promoción y Protección de Inversiones), published on October 22, 1999 (the **Investment Law**). Those claims were dismissed.

3 The Tribunal was originally constituted with Judge Kenneth Keith (president), Mr. L. Yves Fortier (Claimants' appointee) and Sir Ian Brownlie (Respondent's appointee). Following Sir Ian Brownlie's death, Professor Georges Abi-Saab was appointed by Respondent. He partially dissented in the Tribunal's 2013 Decision on Jurisdiction and the Merits. He also dissented to the Tribunal's March 10, 2014, decision rejecting Respondent's First Request for Consideration. Professor Georges Abi-Saab resigned on February 20, 2015, and the Tribunal was reconstituted with Professor Andreas Bucher (appointed by the Chairman of the Administrative Council) replacing Professor Georges Abi-Saab. *See ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Award, March 8, 2019 (**Award**), ¶ 10. On March 21, 2016, Judge Kenneth J. Keith resigned as president of the Tribunal with immediate effect, and the Tribunal was reconstituted on April 22, 2016, with Mr. Eduardo Zuelta (appointed by the Chairman of the Administrative Council) as presiding arbitrator. *See* Award ¶ 19.

4 After the Tribunal's 2013 Decision on Jurisdiction and the Merits, Venezuela submitted three requests for reconsideration. The first two requests were rejected by majority on the basis that the Tribunal lacked the power to examine the Respondent's Application for Reconsideration. *See* Award ¶ 40. Venezuela's third request for reconsideration was based on alleged misrepresentations by Claimants to the Tribunal, and ultimately the Tribunal held a hearing in August 2016 to assess Venezuela's claim. It then dismissed Venezuela's claim in an interim decision on January 17, 2017 (**2017 Interim Decision**). *See* Award ¶¶ 44-49.

5 Award ¶ 37.

6 Award ¶ 37.

7 Award ¶ 37.

8 Award ¶ 37 (Georges Abi-Saab dissented).

9 Award ¶ 26 (emphasis in original).

10 Award ¶ 42.

11 Award ¶ 53 (the tables were broken down by quality of oil for the Hamaca and Petrozuata Projects, but not for the Corocoro Project).

12 Award ¶ 53.

13 Award ¶ 53.

14 Award ¶ 54.

15 Award ¶ 55.

16 Award ¶ 55.

17 Award ¶ 56.

18 Award ¶ 56

19 Award ¶ 58.

20 Award ¶ 59.

21 Award ¶¶ 59-60.

22 Award ¶ 72, discussing Article 9(3).

23 Award ¶ 73, quoting Article 9(5).

24 Award ¶ 85.

[25] Award ¶ 88; *see also* Award ¶ 89.

[26] Award ¶ 91.

[27] Award ¶ 91.

[28] Award ¶ 92.

[29] Award ¶ 93.

[30] *See* Award ¶ 175.

[31] Award ¶¶ 169-170.

[32] Award ¶ 171.

[33] Award ¶ 175.

[34] Award ¶ 177.

[35] Award ¶ 177.

[36] Award ¶ 178.

[37] Award ¶ 180.

[38] Award ¶ 181.

[39] Award ¶ 182, quoting *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Award (Feb. 7, 2017) ¶ 358.

[40] Award ¶ 182.

[41] Award ¶ 193.

[42] Award ¶ 219.

[43] Award ¶ 226.

[44] Award ¶ 227.

[45] Award ¶ 242.

[46] *See* Award ¶ 260.

[47] Award ¶ 277.

[48] Award ¶ 277.

[49] Award ¶ 270.

[50] Award ¶ 275.

[51] Award ¶¶ 278-563.

[52] Award ¶¶ 575-679.

[53] Award ¶¶ 680-716.

[54] Award ¶¶ 717-777.

[55] Award ¶¶ 778-786.

[56] Award ¶¶ 787-829.

[57] Award ¶¶ 830-957.

[58] Award ¶¶ 958-960.

[59] Award ¶¶ 961-965. The Tribunal concluded that Claimants' undertaking to avoid double recovery was an issue which (a) would not arise until the enforcement stage (*see* Award ¶ 963) and (b) would be sufficiently resolved by ordering Claimants not to seek double recovery when seeking enforcement, in full or in part, of the Award rendered by this Tribunal (Award ¶ 965).

[60] Award ¶ 615.

[61] Award ¶ 615.

[62] Award ¶ 615.

[63] Award ¶ 630.

[64] Award ¶ 692.

[65] Award ¶ 754.

[66] Award ¶¶ 751-752.

[67] Award ¶ 753.

[68] Award ¶ 757.

[69] Award ¶ 884.

[70] Award ¶ 884. The Tribunal also recalled that in these circumstances, "[t]here were manifestly grounds to bring the respective opposing positions at least a little bit closer, based in particular on the results of the two hearings held in February and March 2017, where a number of errors in the experts' assumptions were highlighted." *Id.*

[71] Award ¶ 884. Notably, the Tribunal expressed its "serious doubts" that such a discipline even existed "given the extreme discrepancies of the results from highly educated professionals who should have a scientific background allowing conclusions coming closer to one another in their elaboration and in their results." *Id.* at n.650.

[72] *See* Award ¶¶ 886-952.

[73] See Award ¶¶ 952-953.

[74] Award ¶ 953.

[75] Award ¶ 1010.1.

[76] Award ¶ 1010.3.

[77] Award ¶¶ 1010.2, 1010.9. The Tribunal applied the same rate for pre-award and post-award interest, which, according to the Tribunal, should reflect the pertinent industry risk premium, which was 5.5%. *See* Award ¶ 827.

[78] Award ¶ 1010.3. The reason is that this rate was explicitly contained in the compensation provisions of the Petrozuata Association Agreement. *See* Award ¶ 829.

[79] The Tribunal also addressed Respondent's claim that "all of its costs should be deducted from any compensation award ... because the Claimants refused to accept exceedingly generous compensation offers more than nine years ago." Award ¶ 976.

[80] Award ¶ 968.

[81] Award ¶ 969.

[82] Award ¶ 970.

[83] Award ¶ 982.

[84] Award ¶ 991.

[85] Award ¶ 992.

[86] Award ¶ 1004.

[87] *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V.* and *ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela,* ICSID Case No. ARB/07/30, Decision on Rectification, August 29, 2019 (**Decision on Rectification**), ¶ 9.

[88] Decision on Rectification, ¶ 29.

[89] Decision on Rectification, ¶ 56.

[90] Decision on Rectification, ¶ 58.

[91] Decision on Rectification, ¶ 64(1).

[92] Decision on Rectification, ¶ 64(2).

Bilcon of Delaware et al. v. Government of Canada, PCA Case No. 2009-04

Award on Jurisdiction and Liability
March 17, 2015[1]

Award on Damages
January 10, 2012[2]

The Parties
William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware, Inc. (**Investors**), the Government of Canada (**Respondent**). Investors and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties**."

Sector
Mining

Applicable Treaty
North American Free Trade Agreement (**NAFTA**)

Members of the Tribunal
Judge Bruno Simma (president), Professor Bryan Schwartz (Investors' appointee) and Professor Donald McRae (Respondent's appointee)

Background

Bilcon of Delaware, Inc. (**Bilcon**), a U.S. company controlled by William Ralph Clayton, William Richard Clayton, Douglas Clayton and Daniel Clayton, undertook to invest in the development of a quarry and marine terminal at Whites Point quarry, in Digby County, Nova Scotia (**Whites Point Project**). Beginning in 2003, the Government of Canada (**Canada**) and the Government of Nova Scotia conducted an Environmental Assessment (**EA**) of the

Whites Point Project, which was later referred to a Joint Review Panel (**JRP**). Following a JRP review process that included public hearings, the panel issued a recommendation that the Whites Point Project should not be permitted to proceed because it would have a significant and adverse environmental effect on the "community core values" of the Digby Neck area. Subsequently, the Nova Scotian and Canadian federal governments rejected the project.

On May 26, 2008, Bilcon filed a Notice of Arbitration pursuant to Article 3 of the UNCITRAL Rules and NAFTA Articles 1116 and 1120, alleging that the environmental regulatory regime of Canada and Nova Scotia was applied to the Whites Point Project in an arbitrary, discriminatory and unfair manner.

Jurisdiction and Liability

On March 17, 2015, the Tribunal issued its Jurisdiction and Liability Award. The Tribunal unanimously held that it had jurisdiction to the extent Investors' claims were based on events occurring on or after June 17, 2005.[3]

On the merits, a majority of the Tribunal found Canada liable for breach of its obligation under Article 1105(1) of NAFTA requiring that investors be treated "in accordance with international law, including fair and equitable treatment and full protection and security."[4] The majority found that because the JRP's recommendation relied on the application of a "core community values" standard not found in Canadian law, Canada's failure to afford Investors an opportunity to present a case based on this criterion denied Investors due process in violation of NAFTA.[5]

The majority further found that Canada breached its national treatment obligation under Article 1102 of NAFTA by failing to accord to Investors treatment no less favorable than that which Canada accorded its own investors in like circumstances.[6] The majority based its finding on the fact that the standard applied by the JRP had not been applied in other environmental assessments and the government had not shown any legitimate, nondiscriminatory reason for such difference in treatment.

In a dissenting opinion, Professor Donald McRae stated that even if Canada had violated its own domestic laws, that alone did not amount to a breach of international law under Article 1105(1) of NAFTA.[7]

The Tribunal reserved the damages issues for a separate quantum phase of the arbitration.

Quantum

A. Causation

*i. **The Tribunal Applies the 'In All Probability' or 'With a Sufficient Degree of Certainty' Standards of Causation***

On the threshold question of the standard of causation, the Tribunal held that it "must first consider whether a causal link between Respondent's breach of international law and any injury of the Investors has been established at all," noting that "[i]n this regard, the test is whether the Tribunal is 'able to conclude from the case as a whole and with a sufficient degree of certainty' that the damage of losses of the Investors 'would have been averted if the Respondent had acted in compliance with its legal obligations' under NAFTA."[8] Alternatively, the Tribunal determined that it must be "convinced that the Investors' alleged injury would 'in all probability,' not have occurred if the NAFTA violation had not been committed."[9]

Before resolving the substantive issue of whether Investors had adequately proven causation, however, the Tribunal first clarified the scope of its finding of Canada's NAFTA violation, in response to the Parties' competing characterizations of the Tribunal's Jurisdiction and Liability Award. Restating its prior decision, the Tribunal explained that because the Whites Point Project was assessed in a manner that involved a "fundamental departure" from the methodology required under Canadian law, Investors were not afforded a fair opportunity to have their case "considered, assessed and decided in accordance with applicable laws."[10] As a result, the Tribunal concluded that Investors were "denied an expected and just opportunity to have their case considered on its individual merits."[11] The Tribunal further emphasized that it had made no prejudgment as to the approval or approvability of the Project, stating that it "was not conducting … 'its own environmental assessment, in substitution for that of the JRP.'"[12]

*ii. **After Examining a Range of Potential 'But For' Scenarios, the Tribunal Concluded That Investors Had Failed to Prove Causation***

Turning to its analysis of the situation that would have prevailed "in all probability" or "with a sufficient degree of certainty" in the

absence of Canada's breaches of NAFTA, the Tribunal noted that the "principal bone of contention between the Parties is the likelihood that, but for the NAFTA breaches, the Whites Point Project would have obtained all relevant regulatory approvals."[13] Investors claimed that the project complied with all the relevant Canadian environmental laws and regulations and, moreover, that there was no lawful basis under Canadian law for the government to deny environmental approval.[14] Respondent, on the other hand, asserted that in light of evidence that the Whites Point Project could have had adverse environmental effects, and given the discretionary authority of both provincial and federal decision-makers to take into account a broad range of such effects, including socioeconomic conditions, Investors had not proven causation with any degree of certainty.[15]

Applying the "in all probability" or "with a sufficient degree of certainty" standard articulated by the Permanent Court of International Justice in the *Chorzów Factory* case[16] and the International Court of Justice in the *Genocide* case,[17] the Tribunal discussed several potential outcomes in the "but for" scenario in which Canada had undertaken a NAFTA-compliant JRP process. In particular, the Tribunal noted the possibilities that a NAFTA-compliant JRP could have determined that (i) the project would have serious adverse environmental impacts; (ii) negative socioeconomic effects could have outweighed positive effects, such as creation of employment opportunities; or (iii) the project should be approved with conditions rendering it economically unviable. [18] The Tribunal declined to give any weight to evidence from other projects in Nova Scotia, including approval of a larger quarry at Black Point, Nova Scotia, noting the differing conditions involved in the Black Point project, including the ecology of the area.[19]

In light of the various potential outcomes of a NAFTA-compliant JRP process, the Tribunal concluded that Investors had not proven any injury beyond the injury that they "were deprived of an opportunity to have the environmental impact of the Whites Point Project assessed in a fair and non-arbitrary manner." [20] Because Investors failed to prove that the project would have received all necessary approvals and would be operating profitably "in all probability"

or "with a sufficient degree of certainty," the Tribunal held that Investors were entitled only to "compensation equivalent to the value of the opportunity to have the environmental impact of the Whites Point Project assessed in a fair and non-arbitrary manner."[21]

B. Mitigation of Loss

Canada also asserted that Investors should have mitigated their losses by seeking domestic judicial review. After examining the decisions of international courts and tribunals regarding the duty to mitigate, the Tribunal concluded that "[u]nder international law, a failure by an injured State to take reasonable steps to limit the losses it incurred as a result of an internationally wrongful act by another State may result in a reduction of recovery to the extent of the damage that could have been avoided."[22] The duty to mitigate, the Tribunal explained, "is a restriction on compensatory damages," which applies if "(i) a claimant is unreasonably inactive following a breach of treaty; or (ii) a claimant engages in unreasonable conduct following a breach of treaty."[23] Noting that Canada's characterization of the outcome of judicial review was not mitigation of damages, but rather reversal of Investors' injury, the Tribunal expressed "doubts ... that the Investors' duty to mitigate extends so far as to undo the injury (rather than limiting the consequent financial damages)."[24]

In any event, the Tribunal rejected Canada's assertion that judicial review granting Investors another JRP process would have reversed the injury entirely because the Parties had not addressed the question of whether a Canadian court could have remedied the international law violation at issue. In other words, the Tribunal distinguished "[c]onceptually ... the loss of an opportunity to have one's project assessed consistently with Canadian law ... from the loss of an opportunity to have one's project assessed consistently with an international treaty," the latter of which was at issue in this case.[25] Accordingly, the Tribunal found that Investors were not required to challenge the JRP report through domestic judicial review.[26]

C. Calculation of Damages

i. The Tribunal Denied Investors' Claim for Lost Profits

Based on its finding that Investors were entitled to "compensation equivalent to the value of the opportunity to have the environmental impact of the Whites Point Project assessed in a fair and non-arbitrary manner,"[27] the Tribunal proceeded to analyze the proper quantum of damages. As an initial matter, the Tribunal concluded that because Investors failed to prove that the Whites Point Project would have obtained environmental approval, their lost profits claim must be denied.[28]

In *dicta*, the Tribunal observed that although uncertainty may theoretically be reflected in discounted cash flow (**DCF**) valuations, "many tribunals have declined to resort to DCF valuations of future profits where the investment is not yet a going concern which has not generated any historic cash flows."[29] Finding that, with respect to the Whites Point Project, "the uncertainty affecting future income streams is particularly pronounced," the Tribunal concluded that even if project approval had been certain, the Tribunal nonetheless would have declined to award lost profits.[30]

ii. The Tribunal's Valuation of the Opportunity Lost by Investors

Addressing the value of the opportunity to have the environmental impact of the Whites Point Project assessed in a fair and non-arbitrary manner, the Tribunal considered two indicators of value: (i) amounts expended by Investors and (ii) past transactions regarding the quarry site.

1. Primary Indicator of Value: Amounts Expended by Investors

The Tribunal considered the first indicator of the value of the lost opportunity to be Investors' expenditures in pursuing the opportunity to develop a quarry site at Digby Neck. The Tribunal noted that from an economic perspective, the value of the opportunity for a fair and non-arbitrary environmental assessment was "broadly equivalent to the value of the opportunity to develop the quarry site subject to the EA, as the EA was a significant milestone on the path toward building the quarry, and there was no other reason to undertake the EA than the intended quarry development."[31] As a result, the Tribunal determined that it was appropriate to consider Investors' expenses "(i) in the preparation for the environmental assessment, (ii) during the JRP process, and (iii) immediately after the JRP Process to prevent and react to negative decisions from the Nova Scotia and federal Ministers."[32]

2. Secondary Indicators of Value: Past Transactions Regarding the Quarry Site

Recognizing that the amount of Investors' expenditures as defined under the Tribunal's first indicator did not reflect any prospects of a return on investment, the Tribunal stated that such prospects must not be disregarded entirely because a reasonable investor would have expected a margin on its investment.[33] Accordingly, the Tribunal also took into account the implied project value as reflected in three transactions relating to the project site.[34]

Though some details regarding these transactions have been redacted, the Damages Award reflects that the Tribunal took into consideration the extent to which these transactions reflected the economic risks of the permitting process.[35] Noting that while the extent of permitting risks is difficult to measure, the Tribunal found it significant that "market players other than the Claytons, on two occasions in 2002 and 2007, appear to have been unwilling to absorb permitting risks."[36] Based on these considerations, the Tribunal determined that the value of the opportunity lost by Investors was US$7 million.[37]

D. Tax Gross-up

The Tribunal denied Investors' claim for a gross-up of its damages to account for taxes that may apply to the award in the United States, noting the absence of relevant precedent for Investors' request, as well as the incomplete factual record on which to make such a determination.[38]

E. Interest

The Parties agreed that Investors' proposed interest rate – the one-year U.S. Treasury bill yield – was appropriate, and the Parties' experts further agreed that annual compounding of interest was a standard practice.[39] Although the Parties' experts had addressed interest in the context of lost profits damages, the Tribunal applied the agreed-upon interest rate and annual compounding to the value of Investors' lost opportunity, beginning on October 22, 2017, the date the opportunity was lost.[40]

F. The Tribunal Concludes That Investors' Loss Was Direct Rather Than Indirect and Therefore Compensable Under NAFTA Article 1116

Finally, the Tribunal addressed Respondent's argument that the relief requested by Investors in the damages phase was impermissible because NAFTA Article 1116 does not permit an investor to recover losses incurred by its enterprise.[41] Taking into consideration the interpretive rule set forth in Article 31(1) of the Vienna Convention on the Law of Treaties, the subsequent practice of

the NAFTA Parties and NAFTA Chapter Eleven jurisprudence, the Tribunal concluded that Articles 1116 and 1117 preclude claims for reflective loss (i.e., recovery by shareholders of losses incurred by the corporation) under Article 1116.[42]

Notwithstanding its determination that Article 1116 does not permit claims for reflective loss, the Tribunal concluded that an award of compensation to Investors in an amount equivalent to the value of the opportunity to have the environmental impact of the Whites Point Project assessed in a fair and non-arbitrary manner would not be an award for reflective loss.[43] The Tribunal based its conclusion on its finding that the opportunity to develop and submit the Whites Point Project for approval was entirely an opportunity of the Clayton Group in New Jersey, which is owned and run by the individual claimants, rather than an opportunity of Bilcon.[44] Moreover, all of the dealings between the Canadian and Nova Scotian authorities were conducted by or on behalf of the Clayton Group, and the Tribunal found Bilcon to be no more than a conduit ~~to facilitate the~~ Claytons' operations with respect to the project.[45] Accordingly, the Tribunal concluded that compensation was owed directly to Investors pursuant to Article 1116 and not precluded by the prohibition on awards for reflective loss.[46]

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1 *Bilcon of Delaware et al. v. Government of Canada*, PCA Case No. 2009-04, Award on Jurisdiction and Liability (Mar. 17, 2015) (**Jurisdiction and Liability Award**).

2 *Bilcon of Delaware et al. v. Government of Canada*, PCA Case No. 2009-04, Award on Damages (Jan. 10, 2019) (**Damages Award**).

3 Jurisdiction and Liability Award ¶¶ 241-242, 281.

4 Jurisdiction and Liability Award ¶ 742.

5 Jurisdiction and Liability Award ¶¶ 543, 572-573, 600-604.

6 Jurisdiction and Liability Award ¶¶ 724-725.

7 *Bilcon of Delaware et al. v. Government of Canada*, PCA Case No. 2009-04, Dissenting Opinion of Professor Donald McRae ¶¶ 42-43 (Mar. 17, 2015).

8 Damages Award ¶ 114.

9 Damages Award ¶ 114.

10 Damages Award ¶ 126.

11 Damages Award ¶¶ 125-126.

12 Damages Award ¶ 130.

13 Damages Award ¶ 134.

14 Damages Award ¶¶ 137-141.

15 Damages Award ¶¶ 152-166.

16 *Factory At Chorzów (Germany v. Poland)*, Judgment, 1928 P.C.I.J. (ser. A) No. 17 (Sept. 13).

17 *Case Concerning the Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v. Serbia and Montenegro)*, Judgment, 2007 I.C.J. 191 (Feb. 27).

18 Damages Award ¶¶ 168-172.

19 Damages Award ¶¶ 173-174.

20 Damages Award ¶¶ 175-176.

21 Damages Award ¶¶ 175-176.

22 Damages Award ¶ 196.

23 Damages Award ¶ 204.

24 Damages Award ¶ 207.

25 Damages Award ¶ 209.

26 Damages Award ¶ 214.

27 Damages Award ¶ 221.

28 Damages Award ¶ 276.

29 Damages Award ¶ 278.

30 Damages Award ¶ 279.

31 Damages Award ¶ 281.

32 Damages Award ¶ 281.

33 Damages Award ¶ 288.

34 Damages Award ¶ 289.

35 Damages Award ¶ 299.

36 Damages Award ¶ 302.

37 Damages Award ¶ 303.

38 Damages Award ¶¶ 311-315.

39 Damages Award ¶ 318.

40 Damages Award ¶¶ 319-321.

41 Damages Award ¶¶ 322-328.

42 Damages Award ¶¶ 369-389.

43 Damages Award ¶¶ 390-391.

44 Damages Award ¶¶ 392, 396.

45 Damages Award ¶¶ 393-395.

46 Damages Award ¶ 396.

Glencore International A.G. and C.I. Prodeco S.A. v. Republic of Colombia, ICSID Case No. ARB/16/6

Date of the Award

August 27, 2019

The Parties

Glencore International A.G. and C.I. Prodeco S.A. (Claimants), Republic of Colombia (Respondent). Claimants and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties**."

Sector

Mining

Applicable Treaty

Bilateral Investment Treaty between Colombia and Switzerland (BIT)

Members of the Tribunal

Juan Fernando Armesto (president), Oscar M. Garibaldi (Claimants' appointee) and J. Christopher Thomas (Respondent's appointee)

Background[1]

The case concerns the acquisition of Prodeco, a mining company incorporated in Colombia by Glencore in 1995. Prodeco had at the time of Glencore's acquisition a contract for coal mining exploration and exploitation with Carbocol, the Colombian governmental mining agency at the time (Mining Contract).

After Carbocol was replaced by Ingeominas – the Colombian Geological Service (SGC), and the National Mining Agency, the Mining Contract was renegotiated in December 2009. As a result, the parties agreed to change the system for calculating royalties (lowering them) and, in exchange, Prodeco undertook a massive additional program of investment, increasing the productive capacity of the mine.

On December 9, 2009, the last day of validity of the Commitment to Negotiate, Prodeco and Ingeominas met and executed the amendment to the Mining Contract. However, the Colombian Mining Registry denied registration of the amendment because it was

considered to be contrary to Colombia's interests. After Ingeominas suggested minor adjustments to the royalty scheme, the amendment was renegotiated to include terms that were considered more favorable to Colombia, and the amendment was registered.

After the agreed-upon actions under the amendment started, the Contraloría General de la República, as an autonomous agency of the Colombian State entrusted with the supervision and control of the use of public funds, launched an investigation against Ingeominas, concluding that the modifications to the compensation scheme were detrimental to Colombia, since in 2010, Colombia had received less in revenues than it would have received under the previous compensation scheme. Based on these findings, in 2011 the Contraloría closed the preliminary investigation and launched a fiscal liability proceeding against Prodeco and others.

As a result of the fiscal liability proceeding, the Contraloría ordered as precautionary measures the attachment of assets belonging to each of the civil servants indicted in the proceeding as well as three of Prodeco's bank accounts and its shares in a company called Fenoco.

In 2015, the Contraloría issued its decision, concluding that, by executing the amendment to the Mining Contract, Prodeco and the civil servants indicted in the proceeding had incurred fiscal liability, and found them jointly and severally liable to pay compensation to the state in the amount of COP$60 billion (approximately US$25 million at the exchange rate of the time). The Contraloría's main finding was that the amendment failed to formalize Prodeco's obligation to increase production of the mine and how and when such increase would result in an increase in the compensation received by the state. It also found that Prodeco had willfully permitted damage to the state's financial interests in order to obtain greater benefits, acting with fraudulent intent.

In order to assess damages, the Contraloría's decision calculated the difference between the income the state received under the amended contract during the transition period (i.e., during 2010) and the income it would have received had the amendment not been executed. Immediately after the enactment of the Contraloría's decision, Prodeco started a long list of requests and appeals to have the decision overturned. These administrative appeals were unsuccessful.

Having exhausted the available administrative remedies, Prodeco put in motion a judicial process before the Tribunal Administrativo de Cundinamarca. This was the first time the dispute between Prodeco and the Contraloría was submitted to a court of justice – until then, the fiscal liability proceeding had been handled and decided by the Contraloría, a non-judicial agency of the state. Parallel to this proceeding, on March 30, 2012, the SGC invoking clause 39 of the Mining Contract, filed the Procedure for Contractual Annulment with the Tribunal Administrativo de Cundinamarca, requesting that the court declare the nullity of the amendment, arguing that it was detrimental to the general interests of the state. (At the time the arbitral award discussed below was issued, neither of these proceedings had been decided.)

In March 2016, Glencore and Prodeco initiated ICSID arbitration against Colombia, claiming that the fiscal liability fine and the nullification proceedings breached the fair and equitable treatment (FET) and non-impairment standards and the umbrella clause of the BIT, requesting the Tribunal, among other things, to order that Colombia and any other government agency continue to perform the actions under and observe the provisions of the amendment to the Mining Contract, to order restitution of the amount ordered in the

fiscal liability proceeding, and to compensate for the damages caused to Prodeco and Glencore.

Jurisdiction and Liability

A. Jurisdiction and Admissibility

Colombia raised three jurisdictional objections and one admissibility objection: (i) that the Tribunal may not exercise competence over Claimants' claims because the amendment was tainted with illegality; (ii) that Claimants' claim against the conduct of the Contraloría falls outside the Tribunal's jurisdiction by virtue of the fork-in-the-road provision of the BIT; (iii) that the Tribunal umbrella clause claim cannot stand because the dispute-resolution clause of the Mining Contract expressly excludes disputes based on such a clause; and (iv) that Claimants' claims were not ripe for adjudication and were, therefore, inadmissible.[2]

The Tribunal concluded that Respondent had failed to prove its accusations that Prodeco had acted in an illegal way or had deliberately and in bad faith withheld material information from Ingeominas in order to secure the amendment. Consequently, the Tribunal dismissed Respondent's illegality objection. In the same way, it declined the fork-in-the-road objection, since Prodeco had made the clear choice to pursue arbitration, but it declined to exercise jurisdiction over the umbrella clause claim. Finally, with respect to the inadmissibility objection, the Tribunal found that Prodeco had complied with the BIT by pursuing administrative proceedings for six months before initiating arbitration.[3]

B. Merits

On the merits, the Tribunal declared that the Contraloría's conduct in calculating the damages allegedly suffered by Respondent as a result of the execution of the amendment constituted (i) an unreasonable measure that impaired Claimants' investment in Colombia in breach of Article 4(1) of the BIT and (ii) a breach of the FET clause, in violation of Article 4(2) of the BIT, since the methodology on which the Contraloría based its decision to establish the damages allegedly caused to Colombia under the amendment was indeed arbitrary and unreasonable.

The Tribunal concluded that the level of arbitrariness and unreasonableness was high and could not be salvaged by the principle of deference accorded to state agencies when performing supervisory tasks entrusted to them by law. The Tribunal dismissed all other claims, objections and defenses.[4]

Quantum

A. Position of the Parties

Claimants claimed by way of restitution an order that Respondent (i) repay to Prodeco the fiscal liability amount and any other sums that Colombia may, up to the date of the arbitration award, order Prodeco to pay on the basis that the amendment should not apply; and (ii) pay interest from the date of such payment to the date of the award at an annual rate of 9.69 percent, compounded semiannually.

Respondent, on the other hand, argued that Claimants should not be compensated for the fiscal liability amount for three reasons: (i) Claimants and their legal advisors expressed confidence that the Contraloría's decision would be revoked and Prodeco would be fully reimbursed for the amount paid; (ii) even if the judicial recourse against the Contraloría's decision was not successful, Prodeco could recover the amounts paid from the government officers who were held jointly and severally liable by the Contraloría (Respondent qualified Prodeco's failure to do so as contrary to its duty to mitigate damages); and (iii) Prodeco could have requested the suspension of the effects of the Contraloría's decision, which would have enabled it to delay payment until a decision in the procedure for annulment was rendered.

Finally, Respondent argued that any recovery by Claimants needed to be significantly reduced to reflect Claimants' contribution to their own losses, by providing Ingeominas with misleading information, influencing Ingeominas's director and breaching mandatory procedures for amending the Mining Contract.[5]

B. Considerations of the Tribunal Regarding Compensation

i. Standard of Full Reparation[6]

After deciding on Respondent's liability, the Tribunal analyzed Claimants' request that, by way of restitution, Colombia repay to Prodeco the fiscal liability amount, which is the only amount that Prodeco had paid to the Contraloría, in light of the principle of full reparation established in jurisprudence since the *Chorzów Factory* decision. The Tribunal agreed with Claimants' position and determined that Respondent's treaty breach – that is, the Contraloría's wrongful calculation of the damage caused by the execution of the amendment – resulted in Prodeco paying to the Contraloría the fiscal liability amount.

In order to re-establish the situation that existed before Colombia violated the BIT, the Tribunal concluded that Respondent was obligated to repay to Prodeco the amount improperly collected. The Tribunal also clarified that the application of restitution in this case was not materially impossible and did not impose a disproportionate burden on the party in breach – the two factors which exclude the possibility of restitution pursuant to Article 34 of the ILC Articles.

The Tribunal also analyzed how in certain cases full reparation can only be obtained by compensation, relying on Article 36 of the ILC Articles as guidance:

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

ii. Respondent's Counterarguments[7]

Based on this reasoning, the Tribunal decided to supplement restitution with compensation in the form of interest in order to achieve full reparation. Finally, it concluded that Respondent's counterarguments had no merit, since:

(i) Whether Claimants were confident that the annulment procedure would be successful and that the Contraloría would reimburse the fiscal liability amount is irrelevant because the Tribunal found that Respondent had committed an international wrong, and Claimants were therefore entitled to full reparation.

(ii) Whether Prodeco had the right under Colombian law to claim against the civil servants who were found guilty in the fiscal liability proceeding was likewise irrelevant, because even if that right existed, it would not permit Colombia to evade responsibility for its own BIT breaches.

The Tribunal concluded that Prodeco had paid the alleged damages to the Contraloría and that Claimants were accordingly entitled to restitution of such damages from Colombia under international law, regardless of whether Prodeco may have also had an action under Colombian law against the other

civil servants, who in any event could not be held responsible for Colombia's wrongdoing under the BIT.

(iii) The Tribunal also found that Respondent's argument that Prodeco could have asked the court for the suspension of the payment was factually wrong: Prodeco had already paid the fiscal liability amount four months before. Legally, the argument was irrelevant: The possibility of asking a local judge for the suspension of a payment did not relieve Colombia from its international-law obligation to repair in full the harm caused.

Finally, the Tribunal found meritless Respondent's argument that any recovery by Claimants must be significantly reduced to reflect Claimants' contribution to their own losses, because the alleged acts that could constitute contributory fault – that is, providing Ingeominas with misleading information to influence its director and breaching mandatory procedures for amending the Mining Contract – remained unproven (and the Tribunal found that, even if proved, the alleged facts did not contribute to Respondent's own wrongful conduct).

iii. Amount Awarded[8]

The amount claimed by the Contraloría in its decision was denominated in Colombian pesos (COP) and amounted to COP$60 billion. Prodeco paid this amount, plus 12 percent interest accrued until the actual date of payment on January 19, 2016, resulting in a total amount of COP$63 billion.

The Tribunal used Claimants' expert calculation, in accordance with which the amount in COP equated to US$19.1 million, based on the exchange rate on the date of payment. The calculation was not disputed, and Respondent explicitly accepted that the amount paid by Prodeco amounted to US$ 19.1 million.

Finally, the Tribunal accepted Claimants' request that the order of repayment of the fiscal liability amount be denominated in USD. The Tribunal explained that Article 6 of the BIT provides that compensation for expropriation shall be paid in "freely convertible currency" and extended this rule by analogy to compensation due for other breaches of the BIT.

C. Interest[9]

i. Position of the Parties

According to Claimants, interest is a component of full compensation under customary international law, and a state's duty to make reparation arises immediately after its unlawful actions cause harm. Thus, to the extent that payment is delayed, the investor loses the opportunity to invest the compensation.

Claimants argued that the rate at which interest should accrue must ensure full reparation, and consequently, the applicable rate should be equivalent to the return that Claimants would have earned had they been able to invest the funds of which they were deprived, which they submitted was 8.5 percent, later updated to 9.69 percent, because (i) Claimants' cost of capital was a reasonable proxy for the return that Claimants would otherwise have earned on the amounts owed to them as a result of Colombia's treaty breaches; and (ii) the cost of raising funds to replace the fiscal liability amount was Prodeco's cost of capital, not a risk-free rate. Claimants also argued for semiannual compounding.

Respondent did not dispute that interest was appropriate but claimed that the applicable rate should not be Prodeco's cost of capital but rather a risk-free rate and that the Tribunal should award simple interest (but that if it were to award compound interest, compounding should be annual and not every six months).

Respondent argued that the Tribunal should not use the project's weighted average cost of capital to calculate interest because the fiscal liability amount did not represent an investment (or bear any risk) that warranted compensating for such risk. Alternatively, Respondent argued that if the Tribunal considered that Claimants should be awarded pre-award interest at a rate that compensated for risk, interest should be calculated based on Colombia's sovereign default risk because, by paying the fiscal liability amount to Colombia, Prodeco had effectively extended a loan to the state.

ii. Decision of the Tribunal

The Tribunal analyzed BIT Article VI's provision that compensation for expropriation shall include "interest at a normal commercial rate." Although the rule refers to expropriation, the Tribunal determined it could be extended by analogy to compensation for violations of other provisions of the BIT.

However, the Tribunal decided that none of the interest rates proposed by the Parties could be said to fit into the definition of "normal commercial rates" and concluded that LIBOR is the most widely used "normal commercial rate," since it is universally accepted as a valid reference for the calculation of variable interest rates. LIBOR is determined by the equilibrium between supply and demand, representing the interest rate at which banks can borrow funds from other banks in the London interbank

market; it is fixed daily by the British Bankers' Association for different maturities and for different currencies. Since the compensation is expressed in USD, the Tribunal determined the appropriate rate of reference for the calculation of interest should be the LIBOR rate for six-month deposits denominated in USD.

Finally, the Tribunal decided that loans to customers invariably include a surcharge, which must be inserted in the calculation of interest to reflect the financial loss caused to Prodeco by the temporary withholding of money. Since Claimants would not be fully compensated if the interest rate applied did not include an appropriate margin, the Tribunal considered that 2 percent was reasonable, reflecting the surcharge that an average borrower would have to pay for obtaining financing based on LIBOR.

The Tribunal further observed that loan agreements in which interest is calculated on the basis of LIBOR plus a margin usually include a provision that unpaid interest must be capitalized at the end of the interest period. Based on this, the Tribunal decided that interest should be compounded at the end of each six-month interest period.

Finally, the Tribunal concluded that interest should be awarded from the date of payment of the fiscal liability amount and should accrue until all amounts owed in accordance with its award have been finally paid; therefore, the Tribunal determined that from January 19, 2016, until the date of payment, the principal amount of US$ 19.1 million should accrue interest at the LIBOR for six-month deposits plus a margin of 2 percent capitalized semiannually.

D. Taxes and Costs [10]

The Tribunal declared that the amounts awarded be net of Colombian taxes, so that Colombia could not deduct any taxes in respect of such amount and would have to indemnify Claimants for any Colombian taxes imposed thereon, but it denied the request to order Colombia to indemnify Claimants for any double taxation liability that would arise in Switzerland or elsewhere as a result of Colombia's treaty breaches.

Regarding costs, the Tribunal decided that Colombia must reimburse Claimants (i) the costs of the proceedings (net of any final reimbursements by ICSID); (ii) US$1,692,900 as defense expenses; plus (iii) interest on both amounts at the LIBOR for six-month deposits with a margin of 2 percent capitalized semiannually from the date of the award until the date of payment.

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1 *Glencore International A.G. and C.I. Prodeco S.A. v. Republic of Colombia*, ICSID Case No. ARB/16/6, Award, August 27, 2019, § III, "Chronology of fact."

2 Award § IV, "Relief sought by the parties."

3 Award § V, "Jurisdictional and admissibility objections."

4 Award § VI, "Merits of the claims."

5 Award § VI(1), (2).

6 Award § VII(3)A, "The Standard of Full Reparation."

7 Award § VII(3)B, "Respondent's Counter-Arguments."

8 Award § VII(3)C, "Summary."

9 Award § VIII, "Interest."

10 Award §§ IX, "Taxation," and X, "Costs."

CEF Energia B.V. v. The Italian Republic, SCC Arbitration V (2015/158)

Date of the Award
January 16, 2019

The Parties
CEF Energia B.V. (**Claimant**),
The Italian Republic (**Respondent** or **Italy**).

Sector
Solar Energy

Applicable Treaty
The Energy Charter Treaty (**ECT**)

Members of the Tribunal
Mr. Klaus Reichert, S.C. (presiding arbitrator), Prof. Dr. Klaus Sachs (Claimant's appointee), Prof. Giorgio Sacerdoti (Respondent's appointee)

Background

Between 2005 and 2012, the Italian government implemented certain measures and incentive schemes for photovoltaic (**PV**) plants to encourage investment in the sector. Italy wanted to encourage investment so that it could meet EU community targets for the generation and use of renewable energy.

Between 2010 and 2012, Claimant acquired shares in three Italian companies which owned PV plants: Sunholding, Phenix and Enersol. At the time of acquisition, Enersol had already been granted incentive tariffs under the incentive schemes. Sunholding and Phenix subsequently applied for incentive tariffs after the acquisition.

From 2013 to 2015, Italy implemented certain measures that negatively affected PV producers. These measures included (i) enacting a decree known as the Spalma Incentivi Decree, which reduced the tariffs available to PV producers under the incentive schemes; (ii) imposing administrative fees and imbalance costs on PV producers; (iii) broadening the scope of a windfall profits tax to include PV producers; and (iv) classifying PV plants as immovable property for tax purposes.

In November 2015, Claimant commenced an arbitration against Italy pursuant to the ECT, claiming that the measures implemented by Italy from 2013 to 2015 breached the treaty.

Jurisdiction and Liability

On January 16, 2019, the Tribunal issued its award. It found that it had jurisdiction over Claimant's claims and dismissed Italy's jurisdictional objections, including its so-called intra-EU objection.

On the merits, the Tribunal made the following findings:

(i) Italy breached the fair and equitable treatment (**FET**) provision of the ECT by implementing the Spalma Incentivi Decree. Specifically, the implementation of the Spalma Incentivi Decree breached Claimant's legitimate expectations with respect to Enersol's plant. This was the finding of the majority of the Tribunal; Prof. Sacerdoti dissented.

(ii) Italy did not breach the FET provision by way of protection of legitimate expectations in relation to Sunholding and Phenix because at the time of acquisition the incentives were not guaranteed (there were still a number of steps to take), and, therefore, there was no legitimate expectation that Sunholding and Phenix would receive the incentives.

(iii) Italy did not breach the ECT with respect to the other measures complained of – i.e., those relating to the administrative fees and imbalance costs, the windfall profits tax, and the immovable property classification. These measures all constituted "taxation measures" for the purposes of Article 21 of the ECT, and, therefore, the Tribunal did not have jurisdiction to rule on them.

(iv) Italy did not breach the umbrella clause of the ECT, because the measures complained of were compliant with Italian law, and they were addressed to all PV producers.

(v) Italy did not breach its obligation to provide a transparent legal framework or to refrain from unreasonable impairment because the rationale for the Spalma Incentivi Decree was reasonable.

Quantum

Claimant claimed compensation following the customary international law principle of full compensation. In its Statement of Claim, Claimant quoted from *Chorzów Factory*:

> The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.[1]

Italy sought to distinguish *Chorzów Factory*, arguing that the Tribunal should "equitably reduce the amount of compensation (if any) from the full value of damages" given the "regulatory character" and the "fundamental public purpose" of the measures complained of and the absence of fraudulent intent.[2] Italy relied on the *Azurix* annulment decision for its position, asserting that for breaches of ECT obligations other than the expropriation clause, the Tribunal has discretion in determining the approach to damages and is not compelled to use "fair market value" to assess damages in non-expropriation cases.[3]

The Tribunal found that there was no reason to depart from the principles established in the *Chorzów Factory* case. The Tribunal noted that the purpose of the protections in the ECT is not simply to preserve the profitability of an investment, which could result in no compensation being awarded despite a breach of the ECT. The Tribunal concluded that Italy's position would "denude the ECT protections of practical application."[4]

Instead, the Tribunal confirmed that the correct analysis was to determine what the position would have been with respect to Claimant's investment in Enersol had the Spalma Incentivi Decree not been implemented.[5]

To calculate this amount, Claimant's expert compared the value of the Enersol investment just prior to the implementation of the Spalma Incentivi Decree on January 1, 2015 (the date the most significant change was implemented), with the value on the same date but immediately after the implementation. Claimant's expert used the discounted cash flows (**DCF**) method to value the investment.[6]

Italy's expert's position was that it did not dispute Claimant's methodology, but did dispute the assumptions made: "[W]hen the correct essential elements are used, the measures adopted by the Italian Government caused no losses to the Opposing Party. Therefore, a discussion about calculation methods becomes unnecessary."[7] Italy's expert explained that, in its view, Italy did not impair Claimant's investments because the measures were implemented after a period of "over-incentive."[8]

The Tribunal preferred Claimant's methodology:

> The Tribunal prefers the methodology of Mr Edwards, namely, Ms [sic] adoption of DCF. Quite apart from the fact that the DCF method is well-established and accepted by investment arbitration tribunals over many years for the purposes of calculation of compensation, the approach of GRIF would be inconsistent with the even longer-established *Chorzów Factory* principle. The latter requires an assessment of

> the position as if the act, found to be a breach of the international obligation in question, had not occurred. GRIF's approach would, taken to its logical conclusion, would [sic] result in ascertaining whether the investor was nonetheless making a "fair" profit notwithstanding the measure found to be in breach, and, therefore, such "fair" [sic] be sufficient compensation. That is not the established principle found in *Chorzów Factory*.[9]

The Tribunal found that Claimant's expert had set its assumptions, for the purposes of calculating the DCF, in a manner consistent with the Tribunal's findings, and found that Claimant's investment in Enersol had been reduced by EUR 9,600,000 as a result of the Spalma Incentivi Decree.[10]

Interest and Costs

In relation to interest, the Tribunal awarded Claimant annual compound interest at LIBOR plus 2 percent on €9,600,000 from January 1, 2015, until payment in full.

In relation to costs of the arbitration, the Tribunal noted that Claimant had prevailed in the arbitration in a number of respects (in particular on jurisdiction and on its FET claim with respect to Enersol), but not entirely. As a result, while the Tribunal considered Claimant to be the prevailing party, it took into account Claimant's partial success when determining the costs against Italy. The Tribunal concluded that Italy should pay €100,000 to Claimant (the total costs were just over €500,000).

Claimant's total costs (including legal fees, expert fees and expenses, and other costs and expenses) totaled €2,370,126.33. The Tribunal ordered that Italy pay €900,000 toward this amount but dismissed Claimant's claim for interest.

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1 Award dated January 16, 2019, ¶ 262.

2 Award ¶ 263.

3 Award ¶ 263.

4 Award ¶ 266.

5 Award ¶ 267.

6 Award ¶¶ 269-270.

7 Award ¶ 271.

8 Award ¶ 274.

9 Award ¶ 275.

10 Award ¶ 284.

Grenada Private Power Limited and WRB Enterprises, Inc. v. Grenada, ICSID Case No. ARB/17/13

Date of the Award
March 19, 2020

The Parties
Grenada Private Power Limited (**GPP**) and WRB Enterprises, Inc. (**WRB**) (**Claimants**); Grenada (**Respondent**) (together, the **Parties**)

Sector
Energy

Legal Instrument
Contract

Members of the Tribunal
Hon. Ian Binnie, C.C., Q.C. (president), Ms. Olufunke Adekoya SAN (arbitrator), Mr. Richard Boulton, Q.C. (arbitrator)

Background

In 1992, the Government of Grenada (GOG or Respondent) was advised by the World Bank (among other entities) to privatize Grenada Electric Services Company Limited (GRENLEC), the sole electric utility in Grenada. The then party in power embraced the recommendation and, in 1994, sold a controlling interest in GRENLEC to GPP, a Grenadian company indirectly held by WRB, a private company based in Tampa, Florida, U.S. As part of the privatization, the Parties concluded a share purchase agreement (SPA), which was made conditional on the GOG enacting a favorable regulatory structure, pursuant to which GRENLEC was granted an exclusive license for electricity production for a period of 80 years (GRENLEC License). The SPA set out a number of "Repurchase Events," the occurrence of which granted Claimants the right to "put" their shares to

the GOG and obliged the GOG to repurchase them at a price calculated in accordance with a statutory formula (set out in a statutory provision referred to as the Second Schedule). Among the enumerated Repurchase Events was the "annulment, cancellation, limitation, infringement or other impairment to the term, scope or exclusivity of the GRENLEC License."[1]

Two decades later, in 2016, the new party in power enacted regulatory changes to the electricity sector that shortened and narrowed the GRENLEC License and canceled GRENLEC's monopoly. According to Claimants, the regulatory changes resulted in the occurrence of a Repurchase Event, thereby triggering (at Claimants' election) the GOG's obligation to repurchase Claimants' shares in GRENLEC. Claimants therefore put their GRENLEC shares to the GOG for repurchase at the price of EC$182,100,000 (i.e., EC$19 per share), in accordance with the Second Schedule. The Parties were unable to reach an agreement, however, with the GOG ultimately rejecting any obligation to repurchase the shares and refusing to repurchase them at the price claimed.

Consequently, on May 5, 2017, Claimants filed a request for arbitration before ICSID.

Jurisdiction, Liability and Grenada's Counterclaim

Respondent did not raise any jurisdictional objections, and the Tribunal found that it had jurisdiction over Claimants' claims.[2]

With respect to Respondent's liability, the Tribunal first dismissed Respondent's argument that the 1994 package of laws and agreements, including the SPA, was oppressive to Grenada, such that it would be unfair to reward Claimants compensation calculated under the Second Schedule.[3]

The Tribunal next examined whether the abrogation of GRENLEC's monopoly and the substitution of a shorter and narrower period of exclusivity constituted a Repurchase Event. Respondent conceded that the changes to the GRENLEC License might constitute a Repurchase Event, but claimed that pursuant to the SPA, the GOG had the right to intervene in the monopoly where Claimants "committed extreme or willful malfeasance in, or abandonment of, [their] management of GRENLEC of such a nature and to such a degree as warrants" such government action.[4] The Tribunal was unconvinced by Respondent's allegations and found that Claimants had not committed any acts of extreme or willful malfeasance that would justify a denial of Second Schedule compensation.[5] The Tribunal further held that, in any event, in order to invoke the "extreme or willful malfeasance" defense, the SPA stipulated that Respondent was to raise the matter with an ICSID tribunal *before* it abrogated the GRENLEC License, not *after* triggering the Repurchase Event.[6] Failing to abide by this procedural step was fatal to Respondent's "willful malfeasance" defense.[7] Accordingly, the Tribunal concluded that the abrogation of GRENLEC's monopoly constituted a Repurchase Event, such that Claimants were entitled to put their shares to the GOG.[8]

Respondent raised a counterclaim alleging "unfair prejudice and oppression" under the Companies Act of Grenada, which Claimants objected to for lack of jurisdiction.[9] The Tribunal did not side with Claimants on this point and held that ICSID tribunals "may accept jurisdiction if it is impractical to unbundle the claims."[10] The Tribunal went on to dismiss Respondent's counterclaim, however, noting that Respondent had failed to quantify its counterclaim and that the facts alleged in support of it (which closely tracked those raised in Respondent's defense against Claimants' claims) had not been established.[11]

Entitlement to Second Schedule Compensation

Before turning to the issue of quantum, the Tribunal addressed the validity of the Second Schedule

compensation requirement, which, according to Respondent, was ineffective and unenforceable under Grenadian law. Specifically, Respondent contended that the requirement to pay Second Schedule compensation fettered the GOG's ability to regulate Grenada's electricity sector in the public interest and was therefore contrary to the Constitution of Grenada.[12] In addition, Respondent submitted that Second Schedule compensation was extravagantly disproportionate to the true value of Claimants' investment and therefore constituted an unlawful and unenforceable penalty as a matter of Grenadian contract law.[13] For these reasons, Respondent's position was that compensation must be assessed by reference to the fair market value of the shares under the most recent legal regime governing GRENLEC.[14]

A. The Tribunal First Addressed the Questions of Estoppel and Applicable Law

The Tribunal was unreceptive to Claimants' argument that Respondent was estopped from contesting the validity of the Second Schedule compensation requirement "on the basis that it accepted the investment and lived with the arrangement for over 22 years."[15] The Tribunal held that the factual circumstances did not give rise to an estoppel claim because Respondent had neither made representations beyond those in the SPA nor sought to benefit from them.[16]

The Tribunal also discussed the Parties' disagreement with respect to the applicable law. The SPA's applicable law provision provided that the SPA was to be governed by and construed in accordance with the law of Grenada, which was defined to include the Constitution and common law of Grenada.[17] However, this provision also specified that the SPA's repurchase mechanism clause (in addition to other identified clauses of the SPA) were to apply "notwithstanding inconsistent provisions of Grenadian law."[18] The Parties disagreed as to whether this "carve-out" was effective under Grenadian law. Although this was ultimately inconsequential in light of the Tribunal's findings with respect to Respondent's validity challenge (discussed below), the Tribunal found that

the Parties' common intent on the choice of law, including the application of the carve-out, was "clear and unambiguous and w[ould] be given effect."[19]

B. The SPA Is Constitutionally Compliant

The Tribunal rejected Respondent's constitutionality argument. It dismissed as too broad Respondent's contention that a government cannot contractually limit its freedom of action where state welfare is concerned, noting that government functions can be outsourced and that doing so requires contractual commitments that necessarily hamper a government's freedom of action.[20] According to the Tribunal, properly construed, the SPA's provisions did not "fetter" government action.[21] As Respondent acknowledged, "many of the Repurchase Events closely mimic either the substantive obligations typically imposed on host states by bilateral investment treaties or the express stabilization obligations featured in numerous investment arbitration cases."[22] The Tribunal noted that the majority of Repurchase Events specified actions that the GOG was free to undertake but that would give rise to Claimants' right to put its shares to the GOG at the price derived from the Second Schedule formula.[23] In fact, the prospect of having to pay Second Schedule compensation had not deterred the GOG from enacting the regulatory changes at issue.[24]

C. Second Schedule Compensation Is Not a Penalty

The Tribunal also rejected Respondent's argument that Second Schedule compensation constituted an unenforceable penalty. Both Parties relied on a UK Supreme Court decision[25] which specified that the key consideration in this respect is whether there is "an extravagant disproportion between the stipulated sum" to be paid "and the highest level of damages that could possibly arise from the breach."[26] Respondent argued that the resulting Second Schedule compensation (EC$21 per share) was incompatible with valuations that reflected (or more closely reflected) the true value of GRENLEC shares, and placed particular emphasis on the price Claimants had been willing to accept from the GOG in 2012/2013 (EC$8.27 per share) and the Discounted Cash Flow (DCF) valuation put forth by Respondent's expert (EC$5.50 per share).[27]

The Tribunal acknowledged that it appeared that Second Schedule compensation substantially exceeded both the price Claimants had been willing to pay in 2012/2013 and Respondent's DCF valuation. In the absence of an estoppel, however, the Tribunal did not consider Claimants to be bound by the price they would have accepted in 2012/2013. Moreover, for the Tribunal, the relevant question was whether the "extravagantly disproportionate" test applied to the case at all.[28] As Respondent conceded, only provisions that create contractual remedies can be deemed penalties under the applicable case law.[29] In other words, the rule against enforcing penalties applied only in the case of a breach of contract (i.e., to a secondary obligation), not to a primary contractual obligation.[30] Claimants' primary relief was for specific performance of the GOG promise to purchase Claimants' shares, and Respondent could not alter this primary obligation into a secondary obligation to pay damages.[31] Accordingly, the Tribunal concluded that the rule against penalties had no application to the present case.[32]

Quantum

A. The Tribunal Disregarded One of Grenada's Expert Reports

Relevant to the issue of quantum, Respondent submitted that GRENLEC had refused to disclose relevant information to Respondent's experts, thereby forcing them to rely on limited information provided and on publicly available data.[33] At the hearing, two of

Respondent's experts complained that GRENLEC had denied them access to relevant information, with one expert appearing to indicate that his valuation under the Second Schedule could not be deemed reliable without the thorough investigation he was prevented from performing.[34]

The Tribunal accepted that Respondent's experts had been denied information they deemed relevant.[35] However, it held Respondent responsible for failing to invoke the Tribunal's assistance to seek disclosure of this information.[36] The Tribunal noted that it had previously ordered Claimants to disclose financial and other information from GRENLEC.[37] It therefore expected that Respondent was in a position to present its defense and that it would solicit the Tribunal's assistance in this regard if it was not.[38]

Ultimately, because the Tribunal understood that GRENLEC's failure to disclose certain information implied that one of Respondent's expert's valuation was rendered unreliable, the Tribunal concluded that his expert report was of little assistance.[39]

B. The Parties Submitted Competing Second Schedule Valuations

The Second Schedule formula for compensation comprised three parts: (i) a methodology for calculating the value of GRENLEC's net assets, (ii) a methodology for calculating GRENLEC's goodwill and (iii) certain depreciation rates to be used in calculating items (i) and (ii).[40] The valuation date was August 1, 2016, the date on which the regulatory changes enacted by Respondent came into force.[41] The Parties presented the Tribunal with conflicting calculations of the Second Schedule compensation. After certain adjustments, FTI Consulting, called by Claimants, valued Claimants' 50 percent share in GRENLEC at EC$180.941 million.[42] PwC, called by Respondent, valued Claimants' 50 percent share at EC$138.12 million.[43]

C. The Tribunal Adjusted Claimants' Requested Amount

The EC$40 million discrepancy between the Parties' valuations can be explained by their differing views on a number of items. The Tribunal analyzed each of these items and adjusted Claimants' compensation accordingly, as described below.

Deferred taxes:[44] PwC considered that GRENLEC had a deferred tax liability because repurchase would be for a restated value of fixed assets. FTI did not consider that such a liability resulted from a transaction between shareholders. The Tribunal found that there was no evidence of any alleged deferred tax liability, which should therefore not be included in the valuation.

Hurricane Insurance Reserve Fund:[45] PwC treated this item as a liability, whereas FTI treated it as an appropriation of profit. In this regard, Claimants argued that GRENLEC's auditors had incorrectly classified this item as a liability in financial statements certified prior to the valuation date. The Tribunal noted, however, that the Second Schedule required that the valuation be based on financial statements for the five years preceding the revocation of the GRENLEC License. Whether or not the financial statements over the relevant time period were incorrect was irrelevant. The Tribunal therefore found that the Hurricane Insurance Reserve Fund should be treated as a liability.

Computer depreciation:[46] PwC depreciated the GRENLEC computers at a 20 percent rate in light of computer technology's useful life of five years, whereas FTI depreciated them at a rate of 5 percent because it classified computers as "furniture and office equipment" within the meaning of the Second Schedule, thereby implying a useful life of 20 years. The Tribunal agreed with Respondent that a 5 percent depreciation rate for computers is unreasonable, noting that the technology has changed since 1994

and that it was obvious as of the valuation date that "a 20-year useful life would yield a wholly unrealistic rate of depreciation and would artificially inflate the valuation."[47] The Tribunal concluded that there was no reason to apply a 5 percent depreciation rate when the Second Schedule included an alternative "reasonable rate test," and therefore accepted the 20 percent depreciation rate advanced by PwC.

Customer contribution to line installation:[48] PwC recognized the associated costs as a refundable liability and therefore valued such liability at EC$7 million. FTI, on the other hand, recognized these costs as nonrefundable and therefore valued only a lesser liability of EC$2.4 million. The Tribunal noted that GRENLEC solely held the relevant information to determine whether any portion of this amount was nonrefundable. Because Claimants had failed to cause GRENLEC to produce such information, the Tribunal inferred that production of such information would not have assisted Claimants' case. The Tribunal therefore found that the entire EC$7 million should be treated as a liability.

Respondent also maintained that FTI had inflated the valuation of assets by including an amount equivalent to customs and import duties that GRENLEC had never paid because of a then-existing tax exemption that no longer existed as of the valuation date. The Tribunal was unreceptive to this argument and held that the value of fixed assets cannot be discounted on the basis of a tax exemption that no longer exists.[49]

Finally, Respondent argued that the valuation was further inflated because FTI included assets that were damaged or destroyed by Hurricane Ivan. In this regard, the Tribunal accepted Claimants' expert's analysis of the financial impact that Hurricane Ivan had on GRENLEC's fixed assets, noting that he had made a reasonable extrapolation based on known facts, while Respondent's expert, who held fewer facts, had failed to make a convincing argument to the contrary.[50]

Applying the corresponding adjustments, and after further deducting dividends paid to Claimants following the Repurchase Event,[51] the Tribunal arrived at a compensation amount of EC$157.7555 million (or US$58,427,962).[52]

Interest

Respondent challenged Claimants' request for pre-award interest from May 3, 2017 (the date on which Respondent was to repurchase the shares), and advanced two arguments in this regard: (i) Grenadian law applied to Claimants' claims and would not grant pre-award interest, and (ii) a good faith dispute existed between the Parties, such that nonpayment of compensation until issuance of the award was justified.[53]

The Tribunal disagreed with Respondent on both points. The Tribunal noted that awarding interest was within its discretion and that the source of its authority in this respect was the ICSID Convention and Rules of Procedure, not Grenadian law.[54] The Tribunal also did not accept Respondent's good faith argument. The Tribunal stated that the issue narrowly pertained to whether Respondent had put forward its "extreme or willful malfeasance" defense in good faith, any presumption of which was rebuttable.[55] According to the Tribunal, the documentary record refuted any good faith presumption attached to Respondent's defense.[56] The Tribunal observed that had Respondent seriously considered Claimants guilty of "extreme or willful malfeasance," it would have applied to an ICSID tribunal prior to abrogating the 80-year monopoly, as envisioned in the SPA.[57] The Tribunal did not doubt that had the purchase price been paid on May 3, 2017, following the abrogation of the 80-year monopoly, Claimants would have used these funds to make an income-generating investment.[58] Accordingly, the Tribunal ordered pre- and post-award interest from May 3, 2017, until payment of

the award (including interest and costs) at the rate fixed for Grenada 91-day Treasury Bills compounded annually.[59]

Costs

The Tribunal recalled the differing approaches to costs in the Parties' respective legal systems.[60] In the U.S., where WRB is based, parties typically bear their own attorney's fees. Grenada, on the other hand, generally follows the British practice of "loser pays." The Tribunal observed, however, that even under the British approach, a distinction is made between "indemnity" and "standard" costs, the latter of which may be less and must satisfy proportionality and reasonableness tests. The Tribunal went on to discuss a number of relevant factors identified by a UK court, which, according to the Tribunal, "reflect the evolving common law approach to cost shifting and provide a useful list of considerations."[61] Finally, the Tribunal referred to ICSID jurisprudence, noting that although ICSID tribunals often follow the "loser pays" principle, this was not systematically the case, and that previous ICSID tribunals had expressed concern when faced with a significant disparity between the parties' claimed costs.[62]

The Tribunal went on to apply the above-mentioned tests to the case. It first commented that Claimants had been substantially successful on most aspects of their claim, both Parties had ample resources to fund the arbitration, and the case had been comprehensively and skillfully presented by both sides.[63] It also noted that despite increasing the complexity of the dispute and Claimants' costs, the manner in which Respondent had presented its defense was understandable under the circumstances of the case and therefore not a significant factor.[64] The Tribunal did consider, however, that Respondent's pursuit of its "extreme or willful malfeasance" defense was unreasonable and at odds with the contemporaneous documentary evidence.[65] Most important, the Tribunal viewed the amount of time Claimants had spent on the case as being "of some concern," and concluded on this basis that Claimants' claimed costs warranted adjustment, as detailed below.

The Tribunal expressed concern with the discrepancy between the amount of costs claimed by Claimants (US$8,156,400.51) and Respondent (US$5,916,030.36). In particular, the Tribunal pointed to the disproportionate amounts spent by Claimants with respect to their interim measures application and additional quantum pleading made necessary by Respondent's actions.[66] In this regard, the Tribunal compared the amount Claimants had expended for the preparation of this additional pleading against the total amount Respondent had expended on its quantum experts for the entire case. Respondent's expenditure was only slightly higher than Claimants' expenditure, despite Respondent's experts discharging a broader mandate that constituted both a DCF and Second Schedule valuation.[67] The Tribunal also noted that Claimants had caused GRENLEC to pay legal and accounting fees that should have been covered by Claimants from the outset.[68] The Tribunal was further concerned with Claimants' submission of a legal opinion on international law by Jan Paulsson, which Respondent had successfully challenged and which, although subsequently included as part of Claimants' legal argument, added little to the submissions already made.[69]

Accordingly, the Tribunal ordered Respondent to pay Claimants' legal fees and disbursements, but only after reducing the amount claimed by 20 percent (for a resulting sum of US$6,333,142.51), and to reimburse Claimants' share of arbitration costs (amounting to US$239,972.37).[70] Finally, the Tribunal acknowledged Claimants' undertaking to reimburse GRENLEC for the legal and accounting services they should have covered from the outset, and recorded it in the award's dispositif.[71]

[1] *Grenada Private Power Limited and WRB Enterprises, Inc. v. Grenada*, ICSID Case No. ARB/17/13, Award, March 19, 2020, ¶ 192.

[2] Award ¶¶ 106-111.

[3] Award ¶¶ 113-140.

[4] Award ¶ 143. *See also* ¶¶ 145-146.

[5] Award ¶¶ 151-174.

[6] Award ¶ 187.

[7] Award ¶ 188.

[8] Award ¶¶ 189-190.

[9] Award ¶¶ 353, 357.

[10] Award ¶ 359.

[11] Award ¶¶ 361-362.

[12] Award ¶ 194.

[13] *Id.*

[14] *Id.*

[15] Award ¶ 206.

[16] Award ¶¶ 208-210.

[17] Award ¶ 211.

[18] Award ¶¶ 212-213.

[19] Award ¶¶ 215-217.

[20] Award ¶ 221.

[21] Award ¶ 229.

[22] Award ¶ 230.

[23] Award ¶ 229.

[24] *Id.*

[25] The Parties relied primarily on *Cavendish Square Holding BV v. Talal El Makdessi* [2015] UKSC 67, whose application to contracts governed by Grenadian law was confirmed by Grenadian courts. *See* Award ¶ 232.

[26] Award ¶ 232.

[27] *Id.*

[28] Award ¶ 251.

[29] Award ¶ 253.

[30] Award ¶ 252.

[31] Award ¶ 258.

[32] Award ¶ 255.

[33] Award ¶ 266.

[34] Award ¶¶ 267-272.

[35] Award ¶ 273.

[36] *Id.*

[37] Award ¶ 274.

[38] *Id.*

[39] *Id.*

[40] Award ¶ 264.

[41] *See, e.g.*, Award ¶ 260.

[42] *Id.*

[43] *Id.*

[44] Award ¶¶ 281, 283-284.

[45] Award ¶¶ 281, 286-290.

[46] Award ¶¶ 281, 291-302.

[47] Award ¶ 301.

[48] Award ¶¶ 281, 303-306.

[49] Award ¶¶ 281, 307-310.

[50] Award ¶¶ 281, 311-322.

[51] Following the GOG's refusal to repurchase Claimants' shares in GRENLEC, Claimants caused GRENLEC to continue to pay dividends to GPP after the valuation date. In order to ensure against double compensation, the Tribunal deducted from the Second Schedule compensation awarded a set-off equivalent to the amount of the GRENLEC dividends. *See* Award ¶¶ 351-352.

[52] Award ¶¶ 323-324.

[53] Award ¶ 327.

[54] Award ¶ 333.

[55] Award ¶ 347.

[56] *Id.*

[57] Award ¶ 349.

[58] Award ¶ 334.

[59] Award ¶ 350.

[60] Award ¶ 367.

[61] Award ¶ 368 (referring to *Home Office v. Lownds*, 2002 EWCA Civ 365 (21 March 2002) EWCA).

[62] Award ¶ 370.

[63] Award ¶ 369.

[64] *Id.*

[65] *Id.*

[66] Award ¶ 376.

[67] Award ¶ 378.

[68] Award ¶ 376.

[69] *Id.*

[70] Award ¶¶ 379-380.

[71] *Id.*

Perenco Ecuador Limited v. The Republic of Ecuador, ICSID Case No. ARB/08/6

Date of the Award
September 27, 2019

Decision on Claimant's Application for Dismissal of Respondent's Counterclaims
August 18, 2017

Interim Decision on the Environmental Counterclaim
August 11, 2015

Decision on Ecuador's Reconsideration Motion
April 10, 2015

Decision on Remaining Issues of Jurisdiction and on Liability
September 12, 2014

Decision on Jurisdiction
June 30, 2011

The Parties
Perenco Ecuador Limited (**Claimant** or **Perenco**), Ecuador (**Respondent**) (Empresa Estatal Petróleos Del Ecuador (**Petroecuador**) was a respondent until June 30, 2011). Claimant and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties.**"

Sector
Oil and gas

Applicable Treaty
Bilateral Investment Treaty between Ecuador and France (**BIT**)

Members of the Tribunal
H.E. Judge Peter Tomka (president), Mr. Neil Kaplan, C.B.E., Q.C., S.B.S. (Claimant's appointee) and J. Christopher Thomas, Q.C. (Respondent's appointee)

(The initial composition of the tribunal was Thomas Bingham (president), Charles N. Brower (Claimant's appointee) and J. Christopher Thomas (Respondent's appointee).)

Background

On September 2, 2002, Claimant obtained a 45 percent interest in each of two oil concession

contracts in the Ecuadorian Amazon region (**Participation Contracts for Blocks 7 and 21**). Shortly thereafter, Claimant entered into two joint operating agreements with Burlington and Preussag, which between them held the remaining interest in the blocks. In 2005, Burlington and Claimant (together, **Consortium**) acquired Preussag's remaining interest; Claimant's interest increased to 57.5 percent and 53.75 percent in Blocks 7 and 21, respectively.

The price of oil quadrupled between 2002 and 2006. On April 19, 2006, Ecuador passed Law No. 2006-42 (**Law No. 42**) with the intent of obtaining a share of the "extraordinary" earnings that the oil companies were making as a result of the increased oil prices. Law No. 42 introduced a levy amounting to 50 percent of the extraordinary income obtained from the sale of oil; "extraordinary income" meant the difference between the reference price (i.e., the average market price of oil when the concession contracts were entered into) and the actual price at which the oil was ultimately sold.

Claimant's attempt to challenge the levy in the Ecuadorian courts in 2006 failed, as the Ecuadorian Constitution Tribunal found that Law No. 42 was constitutional and did not violate Ecuadorian civil law principles. On October 4, 2007, Ecuador issued Decree No. 662, amending Law No. 42, which increased the extraordinary income levy from 50 percent to 99 percent.[1]

In April 2008, Claimant filed a request for arbitration (**RFA**) against Ecuador and Petroecuador for breach of the Participation Contracts and the BIT and stopped paying its dues pursuant to Law No. 42. In early 2009, Ecuador invoked a special jurisdiction (**coactivas**) that enabled it to employ a range of enforcement measures to demand the payments due to it under Law No. 42.

In May 2009, the Tribunal issued a Decision on Provisional Measures that requested that Ecuador and Claimant refrain from carrying out any acts which may affect the status quo of the dispute and specifically recommended that Ecuador refrain from demanding that Claimant pay the accrued levy fees.[2] In the meantime, Petroecuador, on behalf of the state, obtained permission from domestic courts to sell Claimant's oil by way of auction.

In response to the actions of the state, the Consortium suspended its operations in Blocks 7 and 21 on July 16, 2009, and Ecuador took control of Blocks 7 and 21 on the same day. In November 2009, the Ministry of Energy and Non-Renewable Natural Resources initiated proceedings to terminate the two oil concessions (**caducidad**). Caducidad was formally declared on July 20, 2010.

Jurisdiction and Liability

On June 30, 2011, the Tribunal issued its Decision on Jurisdiction. It determined that it had no competence over Petroecuador and deferred its decision on its competence over Claimant's BIT claims to the merits phase of the proceedings. It also held that it had competence *ratione materiae* over Claimant's contract claims under the Participation Contracts.

On September 12, 2014, the Tribunal issued its Decision on the Remaining Issues of Jurisdiction and on Liability (**Decision on Liability**). The Tribunal found that while the 50 percent extraordinary income levy did not breach either the Participation Contracts or the BIT, the 99 percent levy did. The Tribunal also found that the declaration of caducidad amounted to expropriation pursuant to the BIT, as it terminated Claimant's interests in the concessions. However, the Tribunal rejected the creeping expropriation argument advanced by Claimant.

Ecuador sought a reconsideration of the Decision on Liability in December 2014, which the Tribunal dismissed. In August 2015, the Tribunal issued an Interim Decision on Counterclaim, encouraging the Parties to settle. However, the Parties were unable

to reach a settlement, and as a result, the Tribunal appointed an independent expert in July 2016 to evaluate the environmental condition of Blocks 7 and 21 and the remediation costs.

The proceedings entered the damages phase with a one-week hearing that commenced on November 9, 2015. The quantum stage comprised a series of hearings and submissions, including Claimant's two applications for dismissal of Respondent's environmental and infrastructure counterclaims, both of which were ultimately rejected. During the quantum phase, Claimant no longer sought the reinstatement of its rights under the Participation Contracts. Instead, it claimed damages in the amount of US$1.572 billion. The value of Ecuador's counterclaims amounted to approximately US$2.5 billion.

The Parties' final submissions on costs were filed on April 19 and May 10, 2019.[3] The award was rendered on September 27, 2019.

Quantum

A. Claimant's Claim

i. The Tribunal's Starting Point

At the outset, the Tribunal identified five key areas of disagreement between the Parties:

(i) The general approach to the valuation of damages – i.e., whether damages are to be assessed *ex ante* or *ex post* and whether on a "layering" basis.

(ii) Whether in the "but for" world there would have been an extension of the Block 7 contract (which was due to expire in August 2010) and, if so, the nature of such an extension and its terms.

(iii) Whether, in estimating the damages for expropriation, the Tribunal should accept the "but for" drilling program for both Block 7 and Block 21 of Mr. John Crick, an advisor to Claimant's Chief Executive Officer, or the more modest drilling program prepared by RPS, Ecuador's technical experts.

(iv) Whether all, or just a portion, of the effects of Law 42 at 99 percent should be assumed away in the "but for" analysis.

(v) Whether a true-up in favor of Ecuador should be applied, the effect of which would be to adjust the damages owed to Perenco.[4]

Before dealing with the disagreements, the Tribunal emphasized that the process of assessing damages is "not an exact science."[5]

ii. The Date of Valuation

The Parties disagreed on the correct date of valuation for the assessment of damages. Claimant insisted on using a single valuation date: July 20, 2010, the date of caducidad. By contrast, Ecuador argued that Claimant was wrong to suggest a single date of valuation, on the basis that it erroneously grouped together a series of breaches that occurred over two and a half years.[6]

The Tribunal accepted Ecuador's submission that the use of a single date for valuing the damage was not appropriate in the circumstances of the case.[7] It stated that it is "well-established that the burden of proving damages lies with the claiming party"[8] and confirmed that, in the absence of creeping expropriation, the appropriate method for calculating damages is by identifying the losses caused by each breach individually at the time of their occurrence.[9] The Tribunal had previously rejected Claimant's claim for creeping expropriation.

It also rejected Claimant's latest argument that Ecuador's actions amounted to an "inter-linked course of conduct." The Tribunal was not convinced that Ecuador's measures were so closely connected that they could be aggregated for the purposes of employing a single valuation date, given their distinct effects.[10] The Tribunal held that the correct approach in these circumstances is to examine each breach at its own time and in its own context, accepting Ecuador's "layering" approach, with modifications.[11]

Finally, in response to Claimant's criticism that Ecuador only evaluated two breaches (i.e., Decree No. 662 and caducidad) and failed to take into account the breaches that occurred in the interim, the Tribunal pointed out that "it is not incumbent upon a respondent to make a claimant's case on damages," noting, "that burden is the claimant's."[12] The Tribunal found that, in these circumstances, Ecuador was entitled to challenge Claimant's approach and was not under any obligation to provide an alternative estimation of damages.

iii. Did Claimant Suffer Loss as a Result of Post-Decree No. 662 FET Breaches?

The Tribunal confirmed that it would award damages for the quantifiable losses caused by Decree No. 662 and the declaration of caducidad. However, when faced with the question of whether the losses suffered as a result of the post-Decree No. 662 breaches – i.e., the breaches of fair and equitable treatment (**FET**) suffered by Claimant after Decree 662 but before the caducidad (i.e., expropriation) – were recoverable,[13] the Tribunal found that they were not. The Tribunal noted that neither Party attempted to quantify damages attributable to that period.[14] In particular, Perenco's failure to adduce any evidence pertaining to the damages sustained as a result of the post-Decree No. 662 FET breaches prevented the Tribunal from awarding damages for those breaches.[15]

iv. The Tribunal's General Approach to the Valuation

The Tribunal decided that it must estimate the damages proximately caused by each breach as of the date of their occurrence and that it would do so primarily on an *ex ante* basis while referring to contemporaneous evidence where possible. In that context, it considered the following:[16]

(i) The financial impact of Decree No. 662 on Claimant's interest in Blocks 7 and 21 as of October 4, 2007.

(ii) The impact of Decree No. 662 on Claimant's drilling plans at the time so as to estimate what they would have been through to contract expiry for both Blocks 7 and 21 in the "but for" scenario (because this issue determined the expected levels of production and hence the projections of cash flows in the "but for" world).

(iii) The damages to which Claimant was entitled as a result of the termination of its contractual rights to Blocks 7 and 21.

(iv) Whether, in the "but for" scenario, Claimant would have benefited from an extension of its operatorship in Block 7 after the expiry of the concession agreement after August 2010.

(v) Ecuador's true-up submissions to determine whether any damages calculated under the foregoing heads of loss needed to be adjusted.

(vi) The applicable rates of interest.

The Tribunal decided that it would calculate the damages caused by Decree No. 662 for the period from October 4, 2007, to July 20, 2010, by adding up the discounted cash flows (**DCF**) in the relevant damages model for that period.[17]

Afterward, the Tribunal would perform a separate "clean sheet" valuation to determine the damages sustained after July 2010 as a result of the expropriation, taking into account the then-prevailing market conditions and industry expectations.[18] It held that it would be reasonable and appropriate to employ an *ex ante* willing buyer-willing seller approach, using the price of oil prevailing at the time of the caducidad, in part due to its concerns about the "degree of randomness" associated with using the date of the award as the valuation date.[19]

v. Quantum of Damages Caused by Decree No. 662

The Tribunal found that the 50 percent levy imposed by Law No. 42 did not amount to either breach of contract or breach of treaty. Therefore, the damages could only flow from the date of the introduction of the 99 percent levy on extraordinary income (October 4, 2007, i.e., the date of the first completed breach).

The Tribunal had to determine whether the damages to be awarded as a result of Decree No. 662 should be calculated for the entirety of the 99 percent of extraordinary revenues or just the additional 49 percent (above the legal 50 percent levy). The Tribunal agreed with Claimant that after Decree No. 662 came into effect, Claimant had the right to trigger negotiations with Respondent pursuant to the Participation Contracts. The Tribunal disagreed with Perenco that in the "but for" scenario, Perenco would have succeeded in entirely eliminating Law No. 42 and stabilizing the levy at 0 percent. Instead, the Tribunal held that after Perenco triggered negotiations,

the Parties would have agreed to stabilize the Law No. 42 levy at 33 percent starting from October 5, 2008.[20]

To determine the damages estimate on an *ex ante* basis, the Tribunal had to estimate how many wells Claimant would have drilled in the "but for" scenario.[21] The Tribunal noted in particular that, but for Decree No. 662, Claimant would have drilled more wells in Block 7 up to August 2009 (one year before the expiry of that particular Participation Contract, at which point Perenco would have ceased drilling new wells due to the need to ensure an adequate payback before contract expiry) and in Block 21 (which had another 14 years left before that Participation Contract expired).[22]

vi. The Question of Contract Extension – Loss of Opportunity

One of the key points of contention was whether the Block 7 Participation Contract would have been extended in the "but for" scenario, on the basis that "it accounted for a substantial portion of Perenco's revised claim of a total of US$1.493 billion in damages."[23]

Perenco argued that the Block 7 Participation Contract would have been extended by Ecuador. In turn, Ecuador argued that it had significant discretion with respect to deciding whether to grant such extensions of its oil concessions; the Tribunal largely agreed with Ecuador on this issue. The Tribunal went further and held that even in the "but for" scenario, it would have been unlikely for the Parties to agree on an extension on terms identical to those of the existing Participation Contract.[24]

And while the Tribunal recognized that there was a substantial body of compelling evidence in support of Claimant's submission that Ecuador would have extended Perenco's operatorship on Block 7,[25] it ultimately held that it could not accept Perenco's extension argument, as it was "too remote, uncertain and ultimately too speculative."[26] The Tribunal emphasized that there was no way of establishing what contractual terms the parties might have arrived at[27] and that the adjudicator must seek to avoid awarding speculative damages.[28]

Nonetheless, the Tribunal found that Perenco lost a real opportunity as a result of Ecuador's "unlawful conduct" and that this loss was compensable.[29] The Tribunal had difficulty quantifying the loss of opportunity because there were no hypothetical drilling plans on which the Tribunal could have based possible production and resultant cash flow figures.[30]

After a discussion by the Parties of the relevance of the award in *Gemplus v. Mexico*,[31] the Tribunal pointed out that (i) there was no certainty or realistic expectation of this project's profitability as originally envisaged, but there was nonetheless a reasonable opportunity; and (ii) that opportunity, however small, "has monetary value."[32]

The Tribunal decided that an award of US$25 million would be appropriate for the loss of opportunity stemming from the non-extension of the contract, on the basis that (i) Block 7 was a proven field with valuable reserves, (ii) there was "no question" that Perenco wanted to stay in Ecuador and (iii) there was considerable evidence that Ecuador would have preferred Claimant to remain.[33] It held that Claimant had suffered "a loss of opportunity to have the contract extended, rather than the loss of a fully crystallised legal right to an extension of

a contract, the expected cash flows of which could be modelled on a DCF basis."[34]

vii. Contributory Negligence

The Tribunal was unconvinced by the majority of Ecuador's arguments that Perenco's entitlement to damages should be reduced as a result of its contributory negligence; in particular, the Tribunal did not accept that Claimant's refusal to pay the levied amounts due to the state under Law No. 42 was inherently negligent.[35]

The Tribunal rejected the argument that Claimant's conduct during the negotiation process contributed to its loss.[36] In the eyes of the Tribunal, Ecuador's conduct, because it amounted to a breach of the Participation Contracts, justified Perenco's decision to suspend its operations. The Tribunal held that Perenco's decision not to pay the dues under Law No. 42 did not contribute to Ecuador's decision to expropriate its interest, especially when taking into account Ecuador's failure to comply with the Tribunal's Decision on Provisional Measures, when the Tribunal specifically recommended that Ecuador refrain from taking coactiva measures.[37]

Ultimately, the Tribunal found that it was "wrong to equate a party's zealous protection of its legal rights and interests with wilful conduct or contributory negligence within the meaning of the ILC Articles on the Responsibility of States for Internationally Wrongful Acts."[38]

The Tribunal did agree with Ecuador that if a party claims compensation for the levying of a tax and it has not paid some of that tax, it cannot be compensated for that part of the damages. It also agreed that Claimant contributed to the depressed price of oil obtained in the auctions by threatening to sue prospective buyers of the oil. However, Ecuador had actually benefited from the depressed purchase price as the buyer of the oil; the Tribunal noted that it was unfair for Ecuador to buy oil at a discount and credit Claimant for the depressed value of the oil only.[39]

viii. The Tribunal's "Harmonized Model"

The Tribunal relied on a harmonized DCF model, which was devised with reference to the two models produced by the Parties' experts and adjusted to implement its own findings. The Parties' models had the same overall architecture but differed with respect to several key assumptions.[40]

Broadly, the Tribunal applied its finding that in the "but for" scenario, Law No. 42 would have applied a 50 percent levy from October 2007 to October 2008 and a 33 percent levy after October 2008. The Tribunal had forecast the production levels on an *ex ante* basis.

The Tribunal calculated damages caused by Decree No. 662 by relying on forecasted cash flows for the period of October 2007 to June 2010 discounted to October 2007. For damages stemming from the expropriation, the Tribunal based them on forecasted cash flows from July 2010 until the expiry of the Participation Contracts (August 2010 and June 2021, respectively) discounted back to July 2010. It applied a discount rate of 12 percent, which was the rate used by both Parties' experts.[41]

The Parties' models varied with respect to the projected number of wells drilled after the expropriation. The Tribunal largely accepted Claimant's production profiles but adjusted

the projected number of wells in Block 7 after the expiry of the Participation Contract, as it rejected Claimant's arguments on the extension of the concession.[42]

The Tribunal applied *ex ante* oil prices to the production from each block, taking into account the fact that the oil quality differed for the blocks.[43] The Tribunal largely agreed with the Parties' operating expenses and capital expenditure estimates, adjusting to reflect the *ex ante* modeling perspective and the projected number of wells.[44]

ix. Net Present Value of Cash Flows

In order to arrive at the net present value of cash flows, the Tribunal first forecast the production between October 2007 and June 2010 on the basis of *ex ante* expectations in October 2007 for each month during this period. Likewise, it priced production from July 2010 onward at *ex ante* July 2010 expectations for each month after July 2010. The cash flows derived from each period were discounted at a rate of 12 percent to October 2007 and July 2010, respectively, and added up.[45]

Prejudgment interest was then added to the net present values as of 2007 and 2010 to bring them forward to the date of the award. Monthly yields on 10-year U.S. Treasury notes were used as the risk-free benchmark rate; the rate stood at 4.53 percent in October 2007 and had fallen to 1.75 percent as of September 11, 2019.[46] On this basis, the initial amount of damages estimated to be awarded was US$418.9 million (as of September 2016).

x. The True-up

The Tribunal agreed that a true-up was appropriate in the context of, *inter alia*, Perenco's unpaid Law No. 42 levies, after the Consortium halted the payments in April 2008. The Tribunal held that neither Party emerged from this part of the dispute as a clear winner, and the true-up must reflect this mixed success.[47] The Tribunal concluded that it would be fair to reduce the final award due to Perenco by the true-up amount of US$36.4 million.[48]

xi. Further Adjustments and Conclusion

The Tribunal made a few further adjustments, including accounting for the tax deductibility of certain costs.[49] It also applied an adjustment factor of 1.0776 purportedly to bring the amount of damages forward to the date of the award (from September 2016, the time of the quantum assessment), without, however, explaining how it calculated the adjustment factor. The final sum awarded to Claimant was US$448,820,400.[50]

B. Ecuador's Environmental Counterclaim

i. Claimant's Second Application to Dismiss the Environmental Counterclaim

The Tribunal rejected, by majority, Perenco's second dismissal application. Claimant tried to argue that it did not owe anything to Ecuador on the basis that Ecuador had already been compensated for environmental damage by Burlington, the other member of the Consortium, following the decision of the tribunal in *Burlington v. Ecuador*.[51] Perenco claimed that it should have been regarded as Burlington's alter ego. Perenco filed its second dismissal application after Burlington and Ecuador settled. The application was dismissed in July 2018.

The Tribunal took several issues with Perenco's arguments. First, it viewed them as "troubling," because Claimant had wanted the Tribunal to declare that the Ecuador-Burlington settlement was binding on Perenco and Ecuador in these proceedings.[52]

Second, the majority decided that "its prior decisions are res judicata and cannot be re-opened," which meant that the Tribunal was prevented from reopening and reconsidering its existing findings, given that it had refused Claimant's first dismissal application.[53]

The Tribunal distinguished between the extent to which the *Burlington* tribunal investigated environmental damage caused by the Consortium's work in Blocks 7 and 21, noting that the *Burlington* tribunal "was less troubled by the infirmities in the expert evidence"[54] and pointing to the extensive investigation it ordered the independent expert to carry out in the Perenco proceedings. It found that it was "far too late" to halt the work carried out by the independent expert by the time Claimant filed its second dismissal application, especially in the light of the fact that it was widely accepted that different tribunals, which were considering similar issues, could arrive at different conclusions.[55] The Tribunal held that it was in a better position than the *Burlington* tribunal to conduct a more rigorous evaluation of the condition of the sites through the work of the independent expert, as the *Burlington* tribunal merely conducted a single site visit and relied on the parties' expert evidence.

The Tribunal also rejected Perenco's submissions that the settlement agreement between Burlington and Ecuador precluded Ecuador from claiming damages from Perenco. The Tribunal confirmed that Perenco could legitimately benefit from the settlement agreement only if there had been a novation of the settlement agreement.

While Perenco contended that the *Burlington* tribunal determined the Consortium's environmental liability to Ecuador as a whole and did not carve out Perenco's liability from its

decision, the majority disagreed. It held that the *Burlington* decision was "determinative of the liability owed by Burlington to Ecuador, but not determinative of the entirety of the environmental harm caused to Ecuador more generally" and noted that the *Burlington* tribunal had clearly anticipated that the present Tribunal could come to a different conclusion on the quantum of damages, leaving the issues of double recovery for the present Tribunal to determine.[56]

ii. The Findings of the Tribunal's Independent Expert

The Tribunal-appointed independent expert estimated the remedial costs to be US$159,881,000.[57] The Parties were given the opportunity to comment on the expert's findings. Ecuador argued that he failed to capture the full extent of the contamination caused by Claimant, whereas Claimant submitted that the expert had exaggerated his volume and cost estimates.

1. Allocation of responsibility

The Tribunal's main challenge stemming from the independent expert's evaluation was determining Claimant's share of the responsibility for the remediation of the contamination.[58] The Tribunal agreed with Perenco that, in principle, it could not be held responsible for any contamination caused by Petroamazonas (the state entity that took over after the concessions were expropriated) after it took over the blocks in July 2009 and for contamination that occurred before Claimant assumed control of operations in 2002.[59]

However, after considering the documentary and expert evidence, the Tribunal found it difficult to identify any environmental damage that was caused exclusively by Claimant's successor. The documentary evidence produced to Perenco "was not as supportive of its contention that a substantial amount of the contamination identified by Mr. Scott MacDonald, the independent expert, should be attributed to Petroamazonas' activities as Perenco had hoped."[60] As a result, the Tribunal held that the "use of a generally applicable discounting factor based exclusively on a split between the length of time that Perenco and Petroamazonas operated in the Blocks would, by itself, be too crude a method of allocating responsibility and insufficiently connected to the record evidence."[61]

The Tribunal was more willing to attribute responsibility for the environmental damage to Perenco's predecessors rather than to its successor, citing contemporaneous documentary evidence indicating that contamination was caused by operators before Perenco assumed operatorship and acknowledging the lower standards of past operations.[62]

The Tribunal tried to avoid using the time-weighted approach where possible by applying other criteria wherever it could, on the basis that the time-weighted approach was biased in favor of Claimant.[63] The Tribunal ultimately arrived at the figure of US$93,638,890.[64]

2. Effect of the Burlington Award

Claimant argued that the amounts paid by Burlington under the settlement agreement should be set off against the remediation costs awarded to Ecuador in the Perenco proceedings.[65] The Tribunal accepted

Claimant's argument: It held that it was in a far better position than the *Burlington* tribunal to capture and delineate the extent of the contamination in the blocks as a result of the independent expert's work. The Tribunal decided to treat the US$39 million awarded by the *Burlington* tribunal to Ecuador and paid by Burlington in its settlement "as a down payment towards the total amount of damages that the present Tribunal has determined are payable by Perenco." This resulted in the final figure of US$54,439,517 payable by Perenco to Ecuador.[66]

iii. Tribunal's Direction on Ecuador's Use of the Award

Claimant asked that (i) two separate awards of damages be made, one in favor of each Party, and (ii) the Tribunal order that the damages awarded to Ecuador must be paid into a remediation fund to be used solely for the purpose of remediating the blocks.[67] The Tribunal declined to make two separate awards; instead, it expressed its "firm expectation" that the proceeds of the damages made in favor of Ecuador in the environmental counterclaim will be "devoted to the remediation of the Blocks."[68]

C. Ecuador's Infrastructure Counterclaim

Ecuador raised infrastructure claims stemming from breaches of the Participation Contract. Its claims were identical to those it made in the *Burlington* arbitration; the *Burlington* tribunal made an award of approximately US$2.6 million for the infrastructure claims.[69]

While the Tribunal did award a total of US$2,315,969.15 in respect of Ecuador's infrastructure counterclaims, in the light of double recovery concerns, the Tribunal decided to offset the *Burlington* infrastructure award against its own award. Given that the *Burlington* infrastructure award was higher than the award in the Perenco proceedings, the Tribunal determined that Ecuador had already been made whole on the infrastructure claim. As a result, the infrastructure claim in these proceedings yielded no additional damages.[70]

D. Interest and Costs

Claimant claimed just under US$58 million in costs; Ecuador claimed approximately US$31.6 million in costs. The Tribunal highlighted the fact that the Parties both claimed their costs on the assumption that they would be the prevailing party.[71]

The Tribunal took into account Ecuador's conduct in the arbitration when considering the overall issue of costs; in particular, the Tribunal criticized Ecuador's failure to comply with its Decision on Provisional Measures, noting that had Ecuador complied, the proceedings "would likely have been quite different" and that Perenco would not have suffered detriment to the extent that it did.[72]

The Tribunal found that Claimant was entitled to be reimbursed for its costs, rejecting Ecuador's suggestion to take into consideration the fact that Perenco was awarded approximately one-third of its original claim. The Tribunal did not agree that Perenco's claim was "grossly inflated," stating that it is not uncommon for an award to be for a sum less than that claimed. The Tribunal reduced Perenco's costs by US$6 million because it did not find all of the adduced expert evidence to be useful, ordering Ecuador to reimburse US$23 million plus interest out of the US$29 million spent by Perenco on its principal claims.[73]

By contrast, the Tribunal was less lenient with Ecuador's costs because Ecuador pursued the same environmental counterclaims in both the Perenco and the *Burlington* proceedings. The Tribunal recognized that Ecuador had the right to do so, but deemed it "inefficient, costly and time-consuming."[74]

While the Tribunal recognized that Ecuador ultimately prevailed on its environmental claim, it held that there was a substantial mismatch between the amount claimed by Ecuador and the amount recovered (US$2.5 billion claimed compared with US$50 million awarded). The Tribunal described Ecuador's counterclaims as overstated and based on several incorrect assumptions; it awarded approximately US$6 million plus interest to Ecuador as a result.[75]

The Tribunal specifically singled out the nature, tone and content of Ecuador's submissions on costs, describing its analysis of the proceedings as "not realistic." It took issue with Ecuador's claim that it was the prevailing party in the arbitration, describing the approach as "untenable."[76]

The Tribunal also ordered that (i) Perenco reimburse Petroecuador's "reasonable" costs of approximately US$50,000 plus interest in the arbitration; and (ii) the Parties equally bear the costs of the proceedings and the independent Tribunal's expert (amounting to US$9.5 million in total), on the basis that Perenco prevailed on its principal claim and Ecuador on its counterclaims.

With respect to post-award interest on the damages amounts and on the reimbursement of costs, the Tribunal differentiated between the former (LIBOR for three-month borrowing plus 2 percent, compounded annually) and the latter (simple interest at an annual rate of 3 percent) without providing reasons for this choice and the differentiation.

1. Decision on Remaining Issues of Jurisdiction and on Liability ¶¶ 96-110.
2. Decision on Remaining Issues of Jurisdiction and on Liability ¶¶ 156, 169.
3. For a comprehensive timeline of the procedure of the arbitration, *See* Award ¶ 51.
4. Award ¶ 67.
5. Award ¶ 69.
6. Award ¶¶ 72-73.
7. Award ¶ 108.
8. Award ¶ 74.
9. Award ¶ 74.
10. Award ¶ 83.
11. Award ¶¶ 100, 108-110.
12. Award ¶ 86.
13. For a list of breaches, *see* Award ¶ 103.
14. Award ¶ 104.
15. Award ¶ 112.
16. Award ¶ 125.
17. Award ¶¶ 111-113.
18. Award ¶¶ 108-110, 114-115.
19. Award ¶¶ 112, 116-117.
20. Award ¶ 143.
21. Award ¶ 149.
22. Award ¶ 151.
23. Award ¶ 154.
24. Award ¶¶ 207-208.
25. Award ¶ 211.
26. Award ¶ 220.
27. Award ¶ 212.
28. Award ¶ 219.
29. Award ¶ 221.
30. Award ¶ 223.
31. *Gemplus S.A., SLP S.A., Gemplus Industrial S.A. de C.V. v. Mexico,* ICSID Case No. ARB(AF)/04/3, Award (June 16, 2010), *available at* https://www.italaw.com/sites/default/files/case-documents/ita0357.pdf.
32. Award ¶ 316.
33. Award ¶ 317.
34. Award ¶ 325.
35. Award ¶ 328.
36. Award ¶ 352: "None of the alleged instances of contributory fault said to arise from Perenco's responses to Ecuador's contractual demands can be considered to amount to wilful or negligent conduct within the meaning of Article 39 of the ILC Articles. The Tribunal has already found that it was Ecuador that escalated its demands and threats over time and that for its part Perenco sought to accommodate such demands to the best of its ability."
37. Award ¶¶ 353-354, 357.
38. Award ¶ 359.
39. Award ¶¶ 360-362.
40. Award ¶ 383.
41. Award ¶¶ 389-340, 408.
42. Award ¶¶ 391-397.
43. Award ¶¶ 398-401.
44. Award ¶¶ 402-407.
45. Award ¶ 409.
46. Award ¶ 410.
47. Award ¶ 380.
48. Award ¶ 419.
49. Award ¶¶ 420-422.
50. *Id.*
51. *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5 (formerly *Burlington Resources Inc. and others v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)*), Decision on Ecuador's Counterclaims (February 7, 2017) and Decision on Reconsideration and Award (February 7, 2017), *available at* https://www.italaw.com/sites/default/files/case-documents/italaw8206.pdf and https://www.italaw.com/sites/default/files/case-documents/italaw8208_0.pdf.
52. Award ¶¶ 491-492: "Perenco essentially contends that a res judicata created by a different tribunal, after this Tribunal had spoken, which award was subsequently reflected in a settlement between the parties to that dispute, override[s] the res judicata created by the present Tribunal."
53. Award ¶ 488.
54. Award ¶ 493.
55. Award ¶ 496.
56. Award ¶¶ 506-513.
57. Award ¶ 625.
58. Award ¶ 749.
59. Award ¶¶ 763-765.
60. Award ¶ 783.
61. Award ¶ 785.
62. Award ¶¶ 808-809.
63. Award ¶ 811.
64. Award ¶ 889.
65. Award ¶ 894.
66. Award ¶ 898.
67. Award ¶ 900.
68. Award ¶ 904.
69. Award ¶ 905.
70. Award ¶¶ 965-966.
71. Award ¶ 970.
72. Award ¶ 980.
73. Award ¶ 990.
74. Award ¶ 1006.
75. Award ¶¶ 1015-1017.
76. Award ¶¶ 1018-1019.

Standard Chartered Bank (Hong Kong) Limited v. United Republic of Tanzania, ICSID Case No. ARB/15/41

Date of the Award
October 11, 2019

The Parties
Standard Chartered Bank (**Hong Kong**) Limited (**SCB** or **Claimant**), United Republic of Tanzania (**Tanzania** or **Respondent**). Claimant and Respondent are hereinafter referred to individually as a "**Party**" and collectively as the "**Parties.**"

Sector
Financial and insurance activities

Applicable Treaty
N/A

Members of the Tribunal
Professor Lawrence Boo (president), Justice David Unterhalter SC (Claimants' appointee) and Dr. Kamal Hossain (Respondent's appointee)

Background

This case concerns Tanzania's alleged breaches of Articles 15 and 16 of the Implementation Agreement between Tanzania and Independent Power Tanzania Limited (**IPTL**) dated June 8, 1995 (**Implementation Agreement**), and the validity of SCB's termination of the Implementation Agreement.

In 1994, IPTL was incorporated in Tanzania as a joint venture company between Mechmar Corporation (Malaysia) Berhad (**Mechmar**, a Malaysian company,

holding 70 percent of the shares) and VIP Engineering and Marketing Limited (**VIP**, a Tanzanian company, holding 30 percent of the shares), in furtherance of a Promoters/Shareholders Agreement (**PSA**) dated September 28, 1994, between Mechmar and VIP. In 1995, IPTL and Tanzania Electric Supply Company Limited (**TANESCO**) concluded a Power Purchase Agreement (**PPA**).

Under the PPA, IPTL undertook to build, own and operate an electricity-generating facility (**Facility** or **Power Plant**) in Dar es Salaam, with the electricity generated to be sold and delivered to TANESCO, initially for 20 years, subject to extensions for further periods (**Project**). In parallel, Tanzania and IPTL signed the Implementation Agreement, in which Tanzania gave various undertakings and assurances in favor of IPTL and "its permitted successors and assigns," including undertakings against discriminatory action and expropriation. Tanzania also executed a guarantee, undertaking to pay to IPTL any sums owed by TANESCO under the PPA should TANESCO fail to pay.

IPTL raised the majority of the funds for the construction of the Facility through a loan provided by a consortium of Malaysian banks (**Loan**) under the Loan Facility Agreement relating to the 100 MW Tegeta Power Project **(Facility Agreement**), which was to be repaid from cash flows generated by IPTL under the PPA. IPTL assigned all its present and future rights, title and interest in several contracts, including the PPA and the Implementation Agreement, to the lenders' security agent, under a security deed dated June 28, 1997 (**Security Deed**).

Danaharta Managers (L) Ltd (**Danaharta**) later succeeded the Malaysian banks, and in 2001 and 2003, restructured the Loan with IPTL. In August 2005, SCB acquired the Loan and related security (which included the rights, title and interest in the PPA and the Implementation Agreement) from Danaharta under a sale and purchase agreement.

Multiple disputes were generated from the Project. The key disputes are summarized below.

A. ICSID 1 Proceedings[1]

In 1998, TANESCO commenced ICSID proceedings against IPTL under the PPA, seeking to terminate the PPA on account of breaches by IPTL, and sought adjustment of the tariff (**ICSID 1 Proceedings**). The tribunal in the ICSID 1 Proceedings declared the PPA valid and issued a financial model in accordance with the Parties' agreement, which was to act as the method for calculating the tariff payments to be made by TANESCO to IPTL following the start of commercial operations under the PPA.

B. Tariff Dispute, Interpretation Proceedings and the PPA Arbitration

From May 2007, following certain tariff disputes between TANESCO and IPTL, TANESCO stopped making tariff payments under the PPA, instead placing the sums owed to IPTL in an escrow account (**Escrow Account**). This account was established pursuant to an escrow agreement between Tanzania, IPTL and the Bank of Tanzania, as fulfilment of Tanzania's obligation to provide security (by way of maintaining a two-month equivalent of tariff payments due to IPTL under the PPA). TANESCO's ceasing of tariff payments under the PPA led IPTL to cease payments under the Loan agreement.

In June 2008, IPTL commenced proceedings seeking an interpretation of the ICSID 1 Award, which were later discontinued. Following the discontinuation of the interpretation proceedings, on August 19, 2010, SCB initiated ICSID proceedings against TANESCO, seeking reimbursement of the Loan from the tariffs owed to IPTL under the PPA in its capacity as assignee of the PPA (PPA Arbitration). The tribunal in the PPA Arbitration ruled in favor of SCB, finding that "payment out of the Escrow Account to IPTL/PAP did not discharge TANESCO's obligation to SCB

HK under the PPA," and ordered TANESCO to pay SCB the amount of US$148.4 million plus interest (PPA Award). This decision withstood TANESCO's annulment application.

C. Winding-Up Order and Setting Aside, LCIA Arbitration and Court Order

After the award in the ICSID 1 Proceedings, disputes arose between VIP and Mechmar relating to the attribution of certain costs that the tribunal had decided were not recoverable. In 2002, VIP petitioned Tanzania's courts seeking the winding up of IPTL. Mechmar commenced an arbitration under the London Court of International Arbitration (**LCIA**) rules pursuant to the terms of the PSA. In its final award, the LCIA tribunal ordered VIP to discontinue the winding-up petition.

In 2011, the High Court of Tanzania ordered the winding up of IPTL and appointed a liquidator. This order was later set aside, and a new liquidator was appointed.

In 2013, VIP applied to withdraw its winding-up petition and all ancillary applications, enclosing the share purchase agreement between VIP and Pan Africa Power Solutions (T) Limited (**PAP**) for the sale to PAP of VIP's 30 percent shareholding in IPTL. Hon. John Harold Kulimba Utamwa granted this application and ordered that all of IPTL's affairs, including the PPA and control of the Power Plant, be transferred to PAP.

Subsequently, in September 2013, PAP transferred VIP's 30 percent shareholding and Mechmar's 70 percent shareholding to itself. On October 21, 2013, Tanzania and IPTL entered into an "Agreement for Delivery of Funds to [IPTL]." On November 28 and December 6, 2013, the funds of the Escrow Account were transferred to PAP.

TANESCO continued making payments to IPTL, but the Loan remained undischarged.

D. English Proceedings and Justice Flaux's Judgment

In December 2013, Standard Chartered Bank Malaysia Berhad and SCB started proceedings in the High Court of England and Wales against IPTL, VIP and PAP, among others, under the Facility Agreement, seeking confirmation of the validity of the Loan and of SCB's security over it. Lord Justice Julian Flaux rejected the jurisdictional challenges raised by IPTL, VIP and PAP and confirmed SCB's status as assignee of Danaharta, and therefore confirmed the validity of SCB's loan to IPTL.

E. The Current Arbitration (ICSID 2 Proceedings)

In 2015, SCB initiated an ICSID arbitration (the subject of this case note) against Tanzania in its capacity as the assignee of IPTL's rights under the Implementation Agreement. According to SCB, IPTL's rights were assigned to SCB as the security agent pursuant to the Security Deed. Therefore, it could step into IPTL's shoes and directly enforce IPTL's rights against Tanzania.[2]

Jurisdiction and Liability

Tanzania challenged SCB's standing in the arbitration. It argued that (i) SCB lacked capacity to make any claim. as it was neither a legal assignee under the Implementation Agreement (because IPTL did not obtain Tanzania's consent to assign its rights to SCB) nor had it satisfied the requirements of Tanzanian law as a statutory assignee (i.e., that the assignment was not absolute but by way of charge only and that there was no express notice given to that effect); and (ii) the Tribunal lacked jurisdiction *ratione personae* and *ratione materiae* under Article 25 of the ICSID Convention[3].

A. SCB's Status as Legal Assignee

The Tribunal found that although no "prior" consent was given by Tanzania, it could not be disputed

that "written consent" was subsequently given by Tanzania by way of various documents postdating the assignment. Through those documents, Tanzania "clearly recognize[d] that it consented to the assignment of the Implementation Agreement." The acknowledgments also constituted "both consent to the assignment and the relinquishment of the right to require prior consent," as the consent was given by Tanzania with express reference to Article 15.2 of the Implementation Agreement and thus in contemplation of the requirement of prior consent.[4] The Tribunal thus found that consent was given and the requirement for prior consent was waived.[5]

The Tribunal dismissed Tanzania's arguments that the assignment had not complied with requirements under Tanzanian law, holding that "Clause 3.2 creates an absolute assignment and not an assignment by way of charge only," and that Tanzania had been aware that SCB asserted its interest in the Implementation Agreement as assignee and therefore Tanzania could not complain that it did not know or had no notice of SCB being the assignee.[6] The Tribunal concluded that "SCB has all the rights under the Implementation Agreement assigned to it by Danaharta (as the successor in title of the Lenders) and accordingly has the title and interest to pursue its claims against Tanzania for any breach of the Implementation Agreement in its own name."[7]

B. Jurisdiction Under Article 25 of the ICSID Convention

Tanzania contended that the Tribunal lacked jurisdiction because SCB was not a "National of another Contracting State" and did not have an "investment," given that SCB was not the original lender and the purchase of the Loan could not be classified as an investment.

The Tribunal determined that, in accordance with its finding that SCB was the legal assignee of the Implementation Agreement, SCB was entitled to enforce the rights thereunder in its own name. It was also a "National of another Contracting State," being a Chinese entity.[8]

Regarding Tanzania's investment objection, the Tribunal noted that the Parties' consent "alone could not subject an ordinary commercial transaction or political dispute or non-legal dispute to ICSID for resolution" and that the subject matter of the dispute must concern an investment within the meaning of Article 25 of the ICSID Convention. The Tribunal observed that the *Salini* test that Tanzania had relied on for defining "investment" under the ICSID Convention had "received a mixed following," that other tribunals have taken a different approach,[9] and that the *Salini* test should be applied flexibly, which would be consistent with the objective of the ICSID Convention.[10]

Under that approach, the Tribunal determined that the construction and operation of an infrastructure project such as the Power Plant built by IPTL did qualify as an investment.[11] As to whether SCB's acquisition of the Loan from the original lenders was in the nature of an investment, the Tribunal answered this in the affirmative. The Tribunal accepted that "loans and financial instruments standing alone without any link to some economic venture intended to provide for the improvement of the State's development would not be considered an 'investment'" (i.e., merely a commercial risk versus an investment risk). However, the Tribunal had no doubt that there were investment risks when the original lenders extended the Loan to IPTL to finance the construction and operation of the Facility. The Tribunal held that although SCB was not the original lender, it carried the burden of the original lender. SCB's acquisition of the Loan therefore qualified as an investment. Further, the Tribunal was satisfied that SCB had met the test of contribution to the economic development of the host state, because SCB had been the only potential purchaser of the

Loan from Danaharta, and its purchase had assured IPTL, TANESCO and Tanzania of the continuing availability of financial support for the Power Plant's operation, particularly in circumstances where the contemplated funding from the World Bank was not forthcoming.[12]

C. Liability

On the merits, first the Tribunal found that Tanzania – through various arms of its government, TANESCO and Justice Utamwa – had facilitated the improper transfer of control of IPTL to PAP without due regard for the interests of IPTL and SCB as successor lender and assignee under the Implementation Agreement. According to the Tribunal, Justice Utamwa "recklessly ordered IPTL and the Power Plant to be handed to PAP," while Tanzania "through its agencies ... further aided and abetted the improper release of the Escrow Account, disregarding the legitimate interest of IPTL and SCB HK as successor lender and assignee, ... thereby depriving IPTL and SCB HK of the right to properly exercise their rights of control and gain the economic benefits of their investment." The Tribunal held that such acts are "clear acts of expropriation expressly prohibited" under Article 16 of the Implementation Agreement, and therefore Tanzania breached the Implementation Agreement.[13]

Second, the Tribunal found that Tanzania had breached Article 16.1 of the Implementation Agreement, which prohibited Tanzania from taking any discriminatory action that materially and adversely affected the Project and performance of IPTL's obligations or the enjoyment of IPTL's rights and the investor's rights under the security package. Tanzania was also found to have acted discriminatorily against SCB by relying solely on Justice Utamwa's order and, through its various agencies, to have aided and abetted the release of the funds in the Escrow Account to PAP – actions that consciously ignored the interests of SCB and IPTL in favor of PAP.[14]

Third, the Tribunal found that Tanzania breached Article 15.3 of the Implementation Agreement, which obliged Tanzania to provide security for TANESCO's payment obligations, because the dissipation of monies held in the Escrow Account meant that there was no such security in place.[15]

Fourth, the Tribunal found that SCB had properly shown the existence of an event of default that entitled it to terminate the Implementation Agreement. The Tribunal stated that "[a]s [Tanzania] had committed clear and direct acts of expropriation ... and discrimination ... expressly prohibited under Article 16 of the Implementation Agreement, the right of Termination has accrued in favour of [SCB] ...."[16] The Tribunal reached the same conclusion with regard to Tanzania's failure to provide security for TANESCO's payments and TANESCO's failure to make payments that were due, insofar as those failures were material breaches of the Implementation Agreement constituting

events of default that entitled SCB to terminate the Implementation Agreement.[17]

Fifth, the Tribunal considered that for Tanzania's expropriation of the shares in IPTL and depletion of the Escrow Account, SCB was entitled to be compensated upon termination.[18]

Quantum

A. Preliminary Matters

In the quantum section of its award, the Tribunal began its analysis by noting that SCB had succeeded on its claim for expropriation, for which it was entitled to termination and compensation under Article 20.1(d) of the Implementation Agreement. However, SCB was not merely entitled to compensation – it was also entitled to damages because as assignee of IPTL, it suffered loss and damage during the period leading up to the expropriation. These were distinct heads of claim, and SCB was entitled to all the damages it could prove.[19] The Tribunal's findings on discriminatory action and breach of Article 16.1 of the Implementation Agreement did not add to the damages that SCB could seek, because these had been found to be acts of expropriation for which damages would be awarded.[20]

B. Calculation of Damages

SCB sought damages under two heads, namely: (i) damages for Tanzania's breach of the Implementation Agreement relating to the PPA tariff for the period up to September 2013 (amounts covered by the PPA Award), and (ii) damages in relation to losses (loss of capacity payments) arising from the transfer of IPTL's affairs to PAP in breach of the Implementation Agreement, which relates to the period after September 2013.[21]

i. Damages Related to the Amounts Covered by the PPA Award (Tariff Payments for the Period up to September 2013)

SCB argued that it should be awarded damages in relation to losses during the period up to September 2013 arising from the improper release of funds from the Escrow Account and the making of the top-up payments to IPTL (by then controlled by PAP), which funds should have been used to reduce IPTL's indebtedness under the Facility Agreement. According to SCB, the loss suffered was the difference between the outstanding loan balance under the Facility Agreement as of August 31, 2018, and the outstanding balance had the Escrow Account funds been used to reduce IPTL's indebtedness (released in November and December 2013). Alternatively, the loss suffered was the difference between the outstanding loan balance under the Facility Agreement as of August 31, 2018, and the outstanding balance if the Escrow Account had been used to pay the PPA Award in September 2016.[22]

Tanzania argued that SCB's claim in its post-hearing brief was for an amount based on the estimated reduction of IPTL's indebtedness if the Escrow Account funds had been used to pay the PPA Award in 2016. Tanzania's position was that the amount of SCB's loss should not be based on the payment of the Escrow Account in December 2013 as SCB was not entitled to the Escrow Account funds until the PPA Award was issued. Tanzania also argued that it was inappropriate for SCB to include in its claimed amount the top-up payments made by TANESCO to IPTL, because the top-up payments were made by TANESCO to IPTL only because IPTL and TANESCO agreed to the release of the Escrow Account.[23]

The Tribunal agreed that IPTL had suffered loss of revenue that could have been used to assist it in reducing its debts under the

Facility Agreement, and that just because SCB had obtained the PPA Award in September 2016, it did not mean that SCB was entitled to payment only after that time. The Tribunal noted that the purpose of the Escrow Account was to pay IPTL, which in turn had financial obligations to SCB. The Tribunal also agreed that it was not reasonable to add the top-up payments made by TANESCO to IPTL in the account for the loss because if there had been no agreement for the release of funds from the Escrow Account, TANESCO would not have agreed to make any top-up of the funds.[24]

The Tribunal considered that the best way to ascertain the amount of the loss of the funds was by the difference between the outstanding loan balance under the Facility Agreement as of August 31, 2013 (without taking into account the top-up sum) and the outstanding loan balance had the Escrow Account been used to reduce IPTL's indebtedness upon its release in November and December 2013.[25]

ii. Damages Relating to the PPA Tariff for the Period After September 2013

In addition to claiming damages relating to the PPA tariff for the period up to September 2013, SCB claimed damages in relation to the period after September 2013, in the form of losses arising from the transfer of IPTL's affairs to PAP.[26] SCB argued that the transfer of IPTL's affairs to PAP in breach of the Implementation Agreement deprived IPTL of the ability to earn and apply income under the PPA from September 2013, which would have reduced its debts to Claimant and other creditors. SCB's expert calculated the loss suffered in relation to this aspect of the claim based on the loss of capacity payments and bonuses that IPTL would have expected to receive from TANESCO during the continuing operation of the Facility.

Tanzania disagreed with the SCB expert's calculation, arguing that bonus payments should not be included, applicable corporate income taxes should be accounted for and a risk-free interest rate to cash flows should be applied.

The Tribunal agreed with Tanzania that bonus payments should not be included, as to include them would have been speculative, given that such payments were subject to agreement between IPTL and TANESCO based on each previous year's transactions. The Tribunal also agreed that corporate taxes should not be omitted and that the correct interest rate to be applied in the reckoning of future cash flows was the one stipulated in the Loan Facility Agreement, instead of the default penalty interest rate.[27]

C. Compensation for Termination

In accordance with the Tribunal's finding that SBC was entitled only to compensation for termination based on expropriation, the relevant computation formula was as provided in Row 4 of Schedule 2 of the Implementation Agreement (Article 20.1(d)), and not as provided in Row 2 of Schedule 2 pursuant to Article 20.1(b) of the Implementation Agreement.[28]

Row 4 of Schedule 2 of the Implementation Agreement provided for the consideration of several elements, namely the values of the outstanding loan, the initial capital and any additional equity contributions. As both parties agreed that no additional equity contributions had been made, the Tribunal needed only to consider the values of the outstanding loan and the initial capital.[29]

i. Outstanding Loan

SCB's expert presented three scenarios under which to calculate the outstanding loan, based on the scheduled commercial

operations date (SCOD). In all three scenarios, SCB's expert excluded the value of capital improvements to the Facility and any other outstanding debt incurred by the company that was approved by Tanzania.[30]

In Scenario 1, SCB's expert assessed SCB's loss as "the loan principal and interest outstanding at SCOD plus interest and penalties that accrued to July 2018 (i.e., date of termination) less payments made by IPTL against the outstanding amounts during this period. This is the actual amount outstanding under SCB HK's loan to IPTL."[31] This is the scenario that SCB argued was most appropriate, as "it is closest to the language of the contract" (which is inclusive) and, according to SCB's expert, "is typical in terms of project financing."[32] Tanzania disagreed on the basis that this scenario violated the definition of "outstanding loan" in Schedule 2. According to Tanzania, in this scenario, SCB's expert had "excluded the last drawdown" made by IPTL in January 2000 and added interest and penalties post-SCOD together with insurance costs and enforcement costs, which were all incurred after the SCOD.[33]

In Scenario 2, SCB's expert capped the amount at the "lowest of the amount of the loan principal and interest outstanding at SCOD or any lower level of principal and interest outstanding that is achieved at any time (which happens in the period immediately prior to 31 January 2007)."[34] Both parties agreed that this scenario was not appropriate.[35]

In Scenario 3, SCB's expert calculated the amount of the "loan principal and interest that was outstanding at SCOD less payments made by IPTL against the outstanding amounts through to 31 January 2007." In this scenario, he ignored the "additional interest that in fact accrued under the loan after SCOD" and assumed that "all payments made by IPTL to its lenders are applied against the principal and interest outstanding at SCOD."[36]

The Tribunal agreed with Tanzania that Scenario 1 was not appropriate, as on a plain and simple reading of the definition provided the outstanding loan was limited to "the amount of principal and interest outstanding as at the date of SCOD and requires that any payments made by IPTL be applied to reduce this loan, disregarding interest accruing after the SCOD." Scenario 3 was therefore considered to be the correct and appropriate approach for calculating the value of the outstanding loan.[37]

ii. *Initial Capital*[38]

Regarding the valuation of initial capital, SCB's expert presented two scenarios.

Scenario A used the actual initial equity investment of US$60 million (on the basis that a shareholder's loan represented equity because the shareholder was taking equity risk).[39]

Scenario B used an initial equity investment of US$41.4 million, which was the deemed amount of equity for the purposes of calculating the tariff in the ICSID 1 Award.

Tanzania did not agree to either scenario because the original shareholders did not put in equity (save for US$100) as required but had instead extended a shareholder's loan, which was eventually partially paid down to Mechmar. The value of the initial capital should, according to Tanzania, be zero.

SCB argued that by extending a loan, Mechmar was taking an equity risk and therefore a shareholder loan could constitute its equity contribution. SCB also sought to rely on the PPA Award, in that the PPA tribunal made no finding that Mechmar's funding was not equity for the purposes of the Project documents.

The Tribunal found Tanzania's argument to be correct, in that Mechmar's loan was not equity as generally understood. The Tribunal noted that "[w]hereas equity remains the asset of the company, a loan is a liability of the company and an asset of the lender. As lender, there is a right to demand repayment, and in fact there was repayment." Further, SCB's suggestion that because SCB was a lender, the amount could be considered an outstanding loan was also flawed, because "lender" as mentioned in Schedule 2 referred only to the "Lender" defined in the Implementation Agreement, which would not include shareholders of IPTL.

Accordingly, the Tribunal found that SCB was entitled only to the compensation provided under the outstanding loan.

D. Potential Overlap Between Damages and Compensation[40]

The parties agreed that there were two elements of overlap between SCB's claim for damages calculated under breach of the Implementation Agreement and compensation arising from the termination of the Implementation Agreement.

The first was the outstanding loan, the amount of which may have overlapped with the amount of damages for breach of the Implementation Agreement because the damages reflect the loss suffered by IPTL due to its indebtedness not being reduced. The second was the amount of net cash flows following termination, which could overlap with the amount of damages in relation to net capacity charges and bonuses earned after August 31, 2018.

The Tribunal held that there was no overlap regarding net cash flows, because this element was not relevant in calculating compensation under Row 4 of Schedule 2 of the Implementation Agreement.

As for the amount of the outstanding loan, the Tribunal agreed that it should be deducted in the final reconciliation of damages and compensation due to SCB.

The Tribunal also noted that, "while SCB HK has stepped into the shoes of IPTL and [is] claiming rights as an assignee, it should nevertheless not be entitled to enjoy a windfall." In relation to the final amount to be adjudged as payable to SCB, Tanzania argued that SCB's costs incurred in seeking to collect the loan should be excluded on the basis that SCB's litigation strategy was "abusive and convoluted." However, the Tribunal found that, "but for the discriminatory actions and expropriation, none of those costs would ever have been incurred," and, therefore, "all of these are proper heads of losses and should be allowed" (with the exception of SCB's costs for an arbitration which was dismissed for want of jurisdiction).[41]

Tanzania also urged the Tribunal to order a set-off of whatever amount the Tribunal awarded to SCB against the claims on which it had already succeeded (the Justice Flaux judgment and the PPA Award). The Tribunal observed that because there was no overlap between the parties in the current matter and those in the other proceedings, and neither the PPA Award nor the judgment had been satisfied in whole or in part, there was no basis for suggesting that SCB had obtained double recovery or had any intention to do so. However, the Tribunal noted that SCB "shall not seek recovery beyond the amount adjudged in this Award."

Interest and Costs

The Tribunal limited SCB's recovery to the sum of US$185,449,440.04, that being the amount suffered to discharge the indebtedness due to it under the Facility Agreement.[42] This amount included interest accrued up to August 31, 2018.[43]

SCB, in its post-hearing brief, sought "additional interest and other sums due in relation to the period after August 2018, as calculated by the Facility Agent." The Tribunal determined that until the sum of US$185,449,440.04 was fully paid, SCB should be compensated for the loss of use of such funds and be entitled to interest thereon at the same rate as that provided in the Facility Agreement (i.e., LIBOR six-month plus 2 percent, from September 1, 2018, until the date of full and final payment).[44]

With regard to costs, SCB submitted that the Tribunal had the power to award costs as it deemed appropriate and was not bound to follow the decisions of previous ICSID tribunals;[45] on that basis, it argued that costs should be awarded on the principle that "costs follow the event" and should take into consideration the parties' conduct and the nature of the case they advanced;[46] and that in case the Tribunal ordered Tanzania to pay SCB damages and/or compensation sufficient to pay off the sum due under the Facility Agreement, then it would not seek any order to recover the cost of arbitration.[47]

Tanzania argued that the "loser pays" principle is not followed strictly by ICSID tribunals and that a variety of factors are considered, including the relative success of the parties' claims and the good faith of the unsuccessful party in making those claims.[48] It further argued that SCB's litigation strategy was abusive, and therefore the Tribunal should award costs to Tanzania or, if the Tribunal found in SCB's favor, then it should apportion costs in a manner that did not "unfairly burden" Tanzania.[49]

The Tribunal accepted that in ICSID arbitrations, the principle of "loser pays" is not strictly followed, and that in many cases where the merits of each party's case are mixed, it may be difficult to determine which is the prevailing party. However, the Tribunal in this case found that Tanzania committed acts of expropriation and took discriminatory actions against SCB, with the result that SCB succeeded substantially in its claims. The Tribunal also did not agree that SCB's litigation strategy was abusive, but instead noted that SCB

was genuinely attempting to legally assert its rights through whatever available legal course.[50]

Given those considerations, the Tribunal took the view that Tanzania should bear its own costs, the cost of this arbitration and the costs incurred by SCB in prosecuting the matter. However, as SCB did not seek any order to recover the cost of this arbitration if the damages and compensation awarded were sufficient to discharge Tanzania's indebtedness under the Facility Agreement – which the Tribunal had so found – the Tribunal did not order Tanzania to pay for SCB's costs of the arbitration, but ordered that it should bear its own legal costs and expenses.[51]

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1 Final Award, ICSID Case No. ARB/98/8 (ICSID 1 Award or Award), July 12, 2001.

2 Award ¶ 54.

3 Award ¶ 53.

4 Award ¶ 97.

5 Award ¶ 172.

6 Award ¶¶ 125, 135, 174.

7 Award ¶ 175.

8 Award ¶ 182.

9 Award ¶¶ 194-198.

10 Award ¶ 200.

11 Award ¶ 213.

12 Award ¶¶ 245-246.

13 Award ¶ 380.

14 Award ¶ 441.

15 Award ¶ 448.

16 Award ¶ 463.

17 Award ¶ 466.

18 Award ¶ 471.

19 Award ¶ 477.

20 Award ¶ 478.

21 Award ¶¶ 475, 479.

22 Award ¶ 485.

23 Award ¶ 486.

24 Award ¶ 487.

25 Award ¶ 488.

26 Award ¶ 475.

27 Award ¶¶ 492-495.

28 Award ¶ 497.

29 Award ¶ 499.

30 Award ¶ 502.

31 Award ¶ 501.

32 Award ¶ 504.

33 Award ¶ 504.

34 Award ¶ 501.

35 Award ¶ 503.

36 Award ¶ 501.

37 Award ¶ 505.

38 Award ¶¶ 506-510.

39 Award ¶ 506.

40 Award ¶¶ 511-524.

41 Award ¶ 523.

42 Award ¶ 524.

43 Award ¶¶ 525, 480-481. SCB submitted together with its Post-Hearing Brief dated September 7, 2018, an updated expert report of Mr. Colin Johnson, which included an updated calculation of damages and compensation up to August 31, 2018.

44 Award ¶ 525, § IX.

45 Award ¶ 527.

46 Award ¶ 528.

47 Award ¶¶ 532, 540.

48 Award ¶ 536.

49 Award ¶ 537.

50 Award ¶ 540.

51 Award ¶¶ 540-541.

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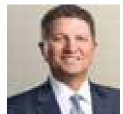
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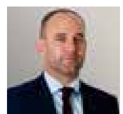
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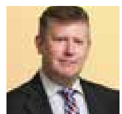
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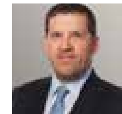
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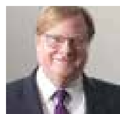
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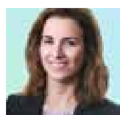
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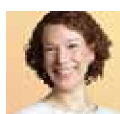
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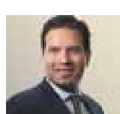
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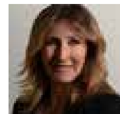
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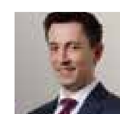
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