A Fair (?) Quantification of Damages in Investor-State Arbitration Proceedings: Reflections from the UNCITRAL Working Group III ISDS Reform Process

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Abstract

This paper considers the proposals advanced by some States in the context of the ISDS reform process at UNCITRAL's Working Group III to curb a perceived tendency towards (too) "high" awards on damages in investment arbitration proceedings and "inconsistent" approaches to valuation methodologies. Based on analysis of the arguments brought forward in that discussion, it is argued that while clear procedural guidelines on the application of the valuation methodologies used by arbitrators would be a commendable outcome of the reform process, other proposals aimed at capping damages based on equitable considerations or contextual factors, including the financial capacity of the host State, pose more questions and may be more properly addressed in other venues or through existing tools.

Keywords: *compensation; damages; ISDS reform; full reparation; contextual factors; equitable considerations; crippling compensation.*

JEL Classification: K33, K41

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1. Introduction

The amounts of damages awarded in the context of investor-State disputes have increased significantly in recent years and represent one of the key areas of criticism about the (un)fairness of the system.[2] Among various fora, these concerns were expressed with emphasis during the discussions taking place within UNCITRAL's Working Group III, which is focusing on possible reform options of investor-State dispute settlement ("ISDS") mechanisms. States and independent delegations have called for reforms in the way damages are calculated in arbitral awards, with variable degrees of success thus far.

This contribution seeks to shed light on certain items advanced by some States

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[2] For recent statistics on damages awarded in investor-state arbitration proceedings, see: Jonathan Bonnitcha, Malcolm Langford, Jose M. Alvarez-Zarate, Daniel Behn, "Damages and ISDS Reform: Between Procedure and Substance", *Journal of International Dispute Settlement*, 14 (2023), 213–241; PricewaterhouseCoopers, *PwC International Arbitration Damages Study*, 2023 update (available at https://www.pwc.co.za/en/assets/pdf/international-arbitration-damages-study-2023.pdf - last access 31 May 2024). Of course, there may be different explanations for these increases, but the topic will not be addressed here.

regarding potential ways to achieve (what these States perceive as) a fairer calculation of damages in investment arbitration. In particular, it is argued that while clearer guidelines on the application of the valuation methodologies currently used by arbitrators would be a commendable outcome of the reform process, other proposals linked – explicitly or implicitly – to limit damages based on equitable considerations or contextual factors, including the financial capacity of the host State, pose more questions, and may be more properly addressed in other venues or through existing tools. Discussions within Working Group III for an ISDS reform began in 2017. During the discussions that followed, States expressed particular concerns regarding "high amount of damages". Overall, the main line of argumentation is that compensation granted to investors is not based on solid mechanisms concerning *quantum* calculations,[3] leading to excessive compensation.[4] According to some submissions, this in turn generates an increasing "chilling effect" on States' ability to regulate.[5]

In 2019, the Working Group took up the issue and requested the Secretariat to "consider how possible work on damages and compensation could be undertaken".[6] The UNCITRAL Secretariat prepared a first draft note on damages in 2021,[7] which was then finalised in July 2022.[8] This note (hereinafter referred to as the "Note on Damages") explicitly addressed the issue of "high amounts of compensation and increased amount of claims" as a matter for consideration in the context of its reform proposals. To tackle this, it proposed the elaboration of "draft treaty provisions or guidelines" concerning, among others, (i) the use of valuation methods, (ii) the "capping of compensation, for instance to the amount actually invested by the investor", and (iii) "[c]ontextual factors, such as the host States' ability to pay for the amounts awarded, the potential 'crippling effect' of an award on the respondent State, and the benefits of the investment to the State's sustainable development goals".[9]

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[3] See, e.g., the submissions by the Government of South Africa (A/CN.9/WG.III/WP.176, para. 73), and Morocco (A/CN.9/WG.III/WP.176, para. 14).

[4] See, e.g., the submission by Burkina Faso (A/CN.9/WG.III/WP.199), para. 4.

[5] See, e.g., the joint submission by the Columbia Center on Sustainable Investment ("CCSI"), the International Institute for Environment and Development ("IIED"), and the International Institute for Sustainable Development ("IISD") of 12 November 2021, p. 1 (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/ccsi_iisd_iied_submission_to_uncitral_wg_iii_on_damages.pdf - last access 31 May 2024); submission of Burkina Faso (A/CN.9/WG.III/WP.199), para. 10. This is not the venue to discuss this statement thoroughly. However, it is probably more accurate to state that the perceived "chilling effect" derives from the fact that there is a general lack of predictability regarding the potential legality of government regulation under international investment law (a matter that should be solved through treaty practice), with unexpected awards on damages being only an indirect consequence of this. Reasoning otherwise would imply that some States are consciously intending to disregard their obligations, but they consider that the price to do so is too high, and thus want to remove this obstacle – if that is the case, the other members of the international community would likely see little incentive to remove an element that ensures compliance.

[6] *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-eighth session (Vienna, 14–18 October 2019)* (A/CN.9/1004), 23 October 2019, para. 104.

[7] *Possible reform of Investor-State dispute settlement (ISDS) – Assessment of damages and compensation – Note by the Secretariat,* Draft version circulated on 21 July 2021, available at: https://uncitral.un.org/sites/uncitral.un.org/files/note_by_the_secretariat_-_assessment_of_damages_and_compensation_.pdf (last access 31 May 2024).

[8] *Possible reform of Investor-State dispute settlement (ISDS) – Assessment of damages and compensation – Note by the Secretariat* (A/CN.9/WG.III/WP.220), 5 July 2022.

[9] Note on Damages, para. 69.

Only part of these topics, however, appear to have found consensus within Working Group III. In particular, the first two items were reflected in the working paper on "Draft provisions on procedural and cross-cutting issues" presented by the Secretariat in 2023 ("Working Paper 231").[10] The document is still being discussed by delegates,[11] but it already provides interesting items for reflection. "Contextual factors", on the other hand, have currently found no space in these drafts and there are no publicly available documents to explain this decision. Some delegations, however, insist that this topic should be addressed within the context of the reform process, particularly in relation to the issue of the economic capacity of the host State as a potential limitation to compensation.[12] This contribution considers both positions, concluding that the current approach of the Secretariat appears overall justified.

In particular, the analysis will proceed as follows. Section 2 provides a brief overview of the current approaches to the calculation of damages in investment arbitration proceedings, focusing on the main areas of criticism that emerged during the debates within Working Group III. Section 3 then analyses the proposals for draft guidelines in the calculation of damages elaborated by the UNCITRAL Secretariat, highlighting their positive aspects, as well as potential issues deriving from the current formulation of some provisions. As it will be illustrated, on a general level, these technical guidelines can provide more certainty and predictability in the calculation of damages, potentially limiting the risk of "excessive" awards on damages.

The focus then turns to the elements that do not appear to have found space in Working Paper 231, starting from the suggested reference to contextual factors and equitable approaches to limit the amount of damages awarded in favour of investors, which are considered under Section 3. It will be argued that these approaches pose, *inter alia*, questions about their interaction with the principle of full reparation, their potential for further inconsistency in arbitral decisions, and the appropriateness of dealing with those matters in the *quantum* phase. Section 4 then addresses the specific issue of so-called "crippling compensation", which represents one of the contextual elements most frequently mentioned to potentially limit damages awarded against States, but raises analogous concerns as those identified for a "contextual" and/or "equitable" capping of compensation. It will be therefore submitted that the inclusion of references to more general "contextual" or "equitable" considerations in procedural tools or guidelines appears more problematic in the current landscape of investor-State proceedings, suggesting that the issue should be rather addressed – if States so intend – at the level of

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[10] *Possible reform of Investor-State dispute settlement (ISDS) – Draft provisions on procedural and cross-cutting issues – Note by the Secretariat* (A/CN.9/WG.III/WP.231), 26 July 2023. The note was followed by some annotations: *Possible reform of Investor-State dispute settlement (ISDS) – Annotations to the draft provisions on procedural and cross-cutting issues – Note by the Secretariat* (A/CN.9/WG.III/WP.232), 31 July 2023.

[11] Discussions are focussing not only on the content of the specific draft provisions, but also on the overall question of the scope of the mandate of Working Group III and areas of priority (see, e.g., the joint submission by CCSI, IIED, IISD and the South Centre of 21 May 2024, available at https://uncitral.un.org//sites/uncitral.un.org/files/media-documents/uncitral/ccsi_iied_iisd_sc_submission_-_may_2024.pdf - last access 31 May 2024).

[12] Submission by Argentina (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/comentarios_argentina_wp.231.pdf - last access 31 May 2024; see also *Summary of the inter-sessional meeting on investor-State dispute settlement (ISDS) reform submitted by the Government of the Republic of Korea* (A/CN.9/WG.III/WP.214), 12 January 2022, para. 46.

sources, and particularly through treaty drafting, or through legal argumentation.

2. Damages in investor-State proceedings: framing the issue

As for every international obligation, the breach of international investment obligations triggers an obligation of reparation upon the responsible State (provided attribution, damage and causation are demonstrated and that no circumstance precluding wrongfulness applies). The conventional sources of international investment obligations generally do not provide indications on the applicable secondary rules,[13] so arbitral tribunals have generally resorted to customary rules, and particularly to the principle of 'full reparation', as elaborated in the famous *dictum* of the Permanent Court of International Justice in the *Factory at Chorzow* case,[14] and as reflected under Article 31 of the Articles on the Responsibility of States for Internationally Wrongful Acts ("ARSIWA").[15]

Although reparation may take the form of restitution, satisfaction, and/or compensation, the first two remedies are hardly awarded in the context of investor-State arbitrations.[16] This entails that in the majority of cases tribunals are called to calculate a monetary sum that is considered sufficient to adequately compensate the investor for the adverse consequences of the unlawful act, i.e. the appropriate amount of damages.[17]

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[13] Some investment treaties provide a standard for compensation that refers to the "fair market value" of the investment – i.e. "the price that an informed and willing buyer would pay for the property in an arm's length transaction" (Silke Noa Elrifai, "Equity-Based Discretion and the Anatomy of Damages Assessment in Investment Treaty Law", *Journal of International Arbitration*, 34, issue 5, 840). This, however, refers only to cases of (lawful) expropriation, so technically it would not apply to unlawful expropriations or other breaches of investment obligations, but it is often applied by analogy, often with some distinctions concerning the valuation date and other variables (e.g. consequential losses) – on the topic, see, *ex multis*: Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (Oxford University Press, 2017), 73 ff.

[14] "The essential principle contained in the actual notion of an illegal act […] is that reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish 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." (Permanent Court of International Justice, *Case Concerning the Factory at Chorzów (Germany v. Poland)*, Judgment, Merits, 13 September 1928, 47). For a critical assessment on whether this was actually an expression of a rule of customary international law at the time of the judgment, see: José Manuel Álvarez-Zarate, "Assessing Damages in Customary International Law – the Chorzów's Tale", in *Custom and its Interpretation in International Investment Law*, ed. Panos Merkouris, Andreas Kilick, José Manuel Álvarez-Zarate, Maciej Żenkiewicz (Cambridge University Press, 2024), 71-89.

[15] International Law Commission, "Responsibility of States for Internationally Wrongful Acts", Yearbook of the International Law Commission, 2001, vol. II (Part Two). Although these had been elaborated to address inter-State matters, they are often applied by analogy to investor-State proceedings (*Burlington Resources v. Ecuador* (ICSID case no. ARB/08/5), Decision on Reconsideration and Award, 7 February 2017, para. 177).

[16] For an exception see *Bernhard Von Pezold et al. v. Zimbabwe* (ICSID case no. ARB/10/15), Award, 28 July 2015, para. 1020. A reason for this is that tribunals are often wary of interfering with States' sovereignty (*LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentina* (ICSID case co. ARB/02/1), Award, 25 July 2007, para. 87.)

[17] In this contribution, the terms 'compensation' and 'damages' will be used interchangeably to indicate the monetary remedy awarded by an international court or tribunal. For a more thorough definition of (and distinction between) the two terms, see, *inter alia*, Marboe, "Calculation of Compensation", paras. 2.01 ff.

The assessment of damages is often linked to the valuation of the investment in dispute. This is obviously the case for situations of direct or indirect expropriations, but also in other circumstances, the valuation of the investment constitutes an important point of reference for counterfactual scenarios (i.e., to calculate the potential value of the investment if the wrongful measures had not occurred). In this context, tribunals often refer to the notion of "fair market value",[18] unless the treaty provides for different indications.[19]

Arbitral practice has developed different methodologies, mostly drawn from the world of economics, to calculate what constitutes the fair market value of an investment. Literature generally differentiates between cost- or asset-based, market-based, and income-based methodologies.[20] This is not the appropriate venue to illustrate all the features of these methodologies in detail,[21] but – broadly speaking and with some inevitable simplifications – they can be summarised as follows:

- Cost- or asset-based methodologies consider the book value or the replacement value of the investment's assets – as documented, for example, in the company's balance sheet –, minus liabilities. In the alternative, it can rely on so-called sunk costs, i.e. the costs incurred by the investor to set up and run its investment up until the valuation date.

- Market-based methodologies rely on market information to assess the value of the investment in dispute. For publicly traded companies, this can be the stock market value of their shares before the adoption of a challenged measure. For privately held companies, the valuation can be assessed using information relating to comparable businesses or transactions (whenever available).

- Income-based approaches focus on the investment's ability to generate revenues in the future to calculate its value at a given valuation date. When opting for this approach, many investment tribunals – if not the vast majority of them –[22] resorted to the Discounted Cash Flow ("DCF") methodology, which assesses the (fair market) value of a business based on expected future cash flows, which are then discounted based on the time value of money and risks.

These methodologies are not mutually exclusive and can be used jointly to reach a better approximation.[23]

The choice and application of these methodologies in the practice of arbitral tribunals have attracted many critiques, which include the (perceived) inconsistency and unpredictability in the valuation of claims,[24] and speculative approaches to income-based

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[18] See n. 13 above.

[19] For example, some BITs or model investment treaties provide – with reference to expropriation – for "fair and adequate" compensation (see, e.g., Article 6 of the DRC-Rwanda bilateral investment treaty of 26 June 2021).

[20] See, e.g., Richard E. Walck, *"Methods of Valuing Losses", in International Investment Law: A Handbook, ed. Marc Bungenberg, Jörn Griebel, Stephan Hobe, August Reinisch (Nomos, 2015),* 1046 ff.; Marboe, "Calculation of compensation", 184 ff. A broader categorisation, adopted also by the UNCITRAL Secretariat in its Note on Damages, distinguishes between backward-looking and forward-looking methodologies (Note on Damages, 7 ff.).

[21] An interested reader can refer again to Marboe, "Calculation of compensation", 184 ff.

[22] Bonnitcha et al., "Damages and ISDS Reform", 222.

[23] Recently, for example, the tribunal in DTEK Krymenergo v. Russia calculated compensation based on a weighted average of the results of the different valuation methodologies (*JSC DTEK Krymenergo v. Russia* (PCA case no. 2018-41), Award, 1 November 2023, para. 886).

[24] "[T]he practice of investment tribunals in the valuation of claims is very divergent. The financial outcome

methodologies, so much so that some authors argue that damages awards are sometimes the result of "esoteric valuation techniques".[25]

One of the main targets of these critiques – which emerged also in the context of Working Group III –[26] is the increased reliance by tribunals on the DCF methodology. Particularly, critics argue that tribunals have relied on this methodology even in the absence of adequate evidence to build reliable assumptions on expected future cash flows because investments were still at their early (or very early) stages. In addition, even when the investment had a clear track record, there had been debates about the items to be considered in the counterfactual scenario, for example concerning regulatory risk or other discount premia. According to some commentators, all these elements have greatly contributed to the general inflation of damages awards.[27]

The *Tethyan Copper v. Pakistan* award is often taken as an emblematic example of these issues.[28] In this case, initiated by an Australian mining company, the tribunal considered that the State's denial of a mining license amounted to a breach of the investor's legitimate expectations under the applicable bilateral investment treaty, and it awarded almost 6 billion USD, including interest, in damages to the claimant (against an original request of over 8 billion USD, plus interest). This amount was calculated using the DCF methodology considering the potential life cycle of the mine, although it still had to be constructed. Commentators often compare this award to the one rendered in the *Bear Creek v. Peru* arbitration,[29] which concluded that the respondent had illegally expropriated the claimant's investment, but considered that there was insufficient evidence to base its calculations on the DCF methodology since the project was at its very early stages and still lacked certain authorisations.[30] Thus, the tribunal relied on a cost-based methodology and awarded slightly over 18 million USD to the claimant (against an original request exceeding 500 million USD).[31]

Without entering into the specificities of these cases to understand if the critiques are well-founded,[32] they are representative of the impact that a proper choice and

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of a proceeding is hardly predictable and sometimes seems arbitrary" (Irmagard. Marboe, "The System of Reparation and Questions of Terminology", in *International Investment Law: A Handbook*, ed. Marc Bungenberg, Jörn Griebel, Stephan Hobe, August Reinisch (Nomos, 2015), 1031-1032). But see Marzal, who argues that there is actually great consistency (Toni Marzal, "Quantum (In)Justice: Rethinking the Calculation of Compensation and Damages in ISDS", *Journal of World Investment & Trade*, no. 22 (2021), 252); *contra*, with specific reference to the use of the DCF methodology, Elrifai, "Equity-Based Discretion", 846 ff.

[25] Juan Carlos Boué, "The Investor-State Dispute Settlement Damages Playbook: To Infinity and Beyond", *Journal of World Investment & Trade*, no. 24 (2023), 373.

[26] Note on Damages, 29; Annotations to Working Paper 231, 73.

[27] Bonnitcha et al., "Damages and ISDS Reform", 224 ff.; Marzal, "Quantum", 253.

[28] *Tethyan Copper Company Pty Limited v. Pakistan* (ICSID case no. ARB/12/1), Award, 12 July 2019. See, *ex multis*: Bonnitcha et al., "Damages and ISDS Reform", 226; Boué, "The Investor-State Dispute Settlement Damages Playbook", 379.

[29] *Bear Creek Mining Corporation v. Peru* (ICSID case no. ARB/14/21), Award, 30 November 2017.

[30] *Ibid.* paras. 600-604.

[31] *Ibid.* para. 738.

[32] At first sight, the diverging outcomes are striking, but one could wonder, *inter alia*, whether the DCF methodology in itself is to blame. In fact, the *Tethyan Copper* tribunal acknowledged that "[i]f the Tribunal reaches the conclusion that there are 'fundamental uncertainties' due to which it is not convinced that the project would have reached the operational stage and would have been able to generate profits, it cannot apply the DCF method", but concluded that the circumstances of the case provided sufficient evidence to that purpose (*Tethyan Copper Company Pty Limited v. Pakistan* (ICSID case no. ARB/12/1), Award, 12 July

application of a given valuation methodology can have on the outcome of a case.[33] For this reason, they have fuelled the widespread and ongoing concerns about the general lack of clear guidelines on the matter, which, so far, ultimately rests on a combination of party *quantum* experts' submissions and arbitrators' discretion.[34] It is therefore unsurprising that the issue was pushed in the agenda of Working Group III, and it is still identified as a topic of high priority.[35]

3. Draft Provision 23 on the Assessment of Damages and Compensation

The draft provisions elaborated by the UNCITRAL Secretariat under Working Paper 231 appear to tackle at least part of the concerns illustrated above. In particular, Draft Provision 23 seeks to provide some procedural guidelines to tribunals to achieve a more consistent approach in the choice and application of the methodologies briefly illustrated in the previous section. As of May 2024, the text of this provision is still being discussed within Working Group III, and it is thus too early to make some definitive comments. Generally speaking, however, the work has the potential to become a useful tool for parties and arbitrators.

For example, para. 4 of the provision seeks to limit resort to income-based methodologies, such as the DCF model, to those cases when there is "satisfactory evidence" to calculate the future cash flows, and when "the investment has been in operation in the territory of the respondent Contracting Party for a sufficient period of time to establish a performance record of profitability."[36] This would provide a narrower scope for the application of the DCF methodology, reducing speculative assumptions, while leaving at the same time the appropriate discretion to arbitral tribunals in the evaluation of evidence.[37] The other paragraphs, as currently formulated, touch upon other important topics, such as the appointment of experts, punitive damages, or speculative claims, which could equally foster procedural consistency on how damages calculation is approached.

2019, paras. 330-331). Thus, the issue rather seems to derive from the appreciation of evidence, instead of the chosen valuation methodology, although the two are inevitably interlinked.

[33] Although Switzerland, in a submission to Working Group III (available at: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/comments_switzerland_on_assessment_of_damages_and_compensation.pdf - last access 31 May 2024), interestingly argued that "from the economic standpoint, different valuation methodologies should in principle yield the same result, provided that the object of the valuation is properly selected." (See para. 7).

[34] Elrifai, "Equity-Based Discretion", 846.

[35] Joint submission by CCSI, IIED, IISD and the South Centre of 21 May 2024, available at https://uncitral.un.org//sites/uncitral.un.org/files/media-documents/uncitral/ccsi_iied_iisd_sc_submission_-_may_2024.pdf, last access 31 May 2024.

[36] It is interesting to note that this indication is in line with the World Bank Guidelines on the Treatment of Foreign Direct Investment of 1992 (World Bank, *Legal Framework for the Treatment of Foreign Direct Investment* vol. 2, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment (1992), available at https://documents1.worldbank.org/curated/pt/955221468766167766/pdf/Guidelines.pdf - last access 31 May 2024), to which some tribunals have already referred to (see e.g. *Deutsche Telekom v. India* (PCA case no. 2014-10), Final Award, 27 May 2020, para. 199).

[37] The opportunity of safeguarding a margin of discretion for arbitrators justifies also the decision not to include a guideline on discount rates, as initially foreseen by the Secretariat (see Secretariat Note on Damages, para. 69, which mentioned: "The use of valuation methods, including the appropriate discount rate to be applied to calculations with the DCF method and calculation of interest").

At this stage, however, some also elements raise some doubts. As said, discussions are still ongoing, so Draft Provision 23 will likely be subject to edits.[38] Yet, for the purposes of this contribution, it is worth pinpointing two potential items of concern.

First, para. 8 addresses one of the potential solutions identified to curb excessive damages awards listed in the Note on Damages, stating: "The Tribunal shall not award monetary damages exceeding the total expenditures (adjusted for inflation) incurred by the claimant in making its investment." Yet, as already noted by some delegations,[39] this guideline appears to stand in contrast with para. 4, which allows tribunals – under certain circumstances – to award damages based on future cash flows.[40] Moreover, this provision appears to go beyond a procedural indication,[41] by effectively derogating to (or, in any case, limiting the scope of) the full reparation standard.

Second, para. 3 of Draft Provision 23 currently directs arbitrators, when "assessing or calculating monetary damages", to consider, *inter alia*, "[a]ny non-compliance by the claimant with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises." Among the various questions that this indication may raise,[42] it is unclear how this element may affect the tribunal's *quantum* considerations. Indeed, the issue appears to pertain more to the merits of the dispute,[43] unless these potential breaches are considered as an element that the tribunal may consider to reduce damages on an equitable basis (a matter that is analysed in the next section).

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[38] For example, one could wonder whether the indication on the valuation date included under para. 1(b) is entirely appropriate and will pass the exam of delegations. The same applies to the implicit exclusion of compound interest under para. 2.

[39] *Report of Working Group III (Investor State Dispute Settlement Reform) on the work of its forty sixth session (Vienna, 9 13 October 2023)* (A/CN.9/1160), 27 October 2023, para. 112; submission by Israel, p. 6 (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/EN/israel_comments.pdf - last access: 31 May 2024); submission by the European Union, p. 25 (available at https://uncitral. un.org/ sites/uncitral.un.org/files/media-documents/uncitral/en/comments_from_the_eu_and_its_ms_wp.231.pdf - last access 31 May 2024.) The Institute for Transnational Arbitration proposed to cancel the paragraph in its entirety (see comments available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/ita_comments_draft_provision_23_wp231.pdf - last access 31 May 2024).

[40] Even if interpreted as a cap, as indicated by the Secretariat (para. 75 of the Annotations to Working Paper 231), the result would be the same, as this would create no incentive for the parties and the tribunal engage in complex discussions about income-based valuations.

[41] A concern that has been expressed by some delegations with respect to some aspects of Draft Provision 23 – see, e.g, the submissions by the USA, at p. 1 (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/usa_.pdf - last access 31 May 2024), and Switzerland, at para. 1 (available at: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/comments_switzerland_on_assessment_of_damages_and_compensation.pdf - last access 31 May 2024).

[42] Among others, applying this provision would require the tribunal to first assess (on which jurisdictional basis?) whether the investor has failed to comply with these (soft law, and thus theoretically non-binding?) obligations. On this point, see the comments of the Institute for Transnational Arbitration, (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/ita_comments_draft_provision_23_wp231.pdf - last access 31 May 2024), and the European Union (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/comments_from_the_eu_and_its_ms_wp.231.pdf - last access 31 May 2024).

[43] Other views may be possible. For example, Israel argues that these could be considered this circumstance when assessing the investor's potential contributory fault (see pp. 6-7 of the State's submission, available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/EN/israel_comments.pdf - last access 31 May 2024).

Apart from these potentially problematic aspects, Draft Provision 23 appears in line with the expressed need to achieve a "clear valuation method to curb the risk of abuse" and to achieve more "objective and transparent criteria for determining the compensation".[44] Moreover, these indications may also lower procedural costs by reducing discussions at the *quantum* stage. Of course, a margin of uncertainty deriving from interpretation will remain inevitable (and perhaps rightly so), but States have the opportunity to set precious points of reference to guide the arbitration process.

4. Contextual factors: a call for increased resort to equitable solutions?

As noted in the previous section, Draft Provision 23 addressed two of the three areas of work identified by the UNCITRAL Secretariat in its 2022 Note on Damages. The third item on the list, pertaining to "contextual factors", was left outside the scope of Working Paper 231.[45] This section seeks to understand the relevance of this omission, by identifying some common features of these "contextual circumstances" and understanding their potential relevance to the *quantum* phase of investment proceedings. The documents circulated within Working Group III do not contain a specific definition of "contextual circumstances" relevant to the limitation of damages, but they do provide some specific examples that can guide the interpretation of this notion. The Note on Damages lists three examples of "contextual factors" that may be considered in the assessment of damages to limit high compensation amounts: (i) the financial capacity of the host State, (ii) the potentially crippling effect of the compensation on the host State, and (iii) the "benefits of the investment to the State's sustainable development goals." The submissions of some States add other indications. Colombia, for example, referred to the need to balance "equitably public interest with the interest of the harmed investor, considering all relevant circumstances",[46] referring to a formulation that has been adopted in some model bilateral investment treaties.[47] Burkina Faso also mentioned "public interest as a ground for interference with the investment" and "the ability of the host State to pay".[48]

What these examples appear to have in common is that they seek to invoke the broader circumstances in which the investment was operating – e.g., the economic and political situation of the host State, its level of achievement of sustainable development goals – to limit what would otherwise have been a 'standard' calculation of damages. In

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[44] Note on Damages, paras. 5 and 7.

[45] To be sure, Draft Provision 23 does address some contextual circumstances under para. 3, but these do not appear to coincide with the notion that the Secretariat (based on the suggestions of some States) had in mind in its Note on Damages, as understood in this section.

[46] Submission by Colombia (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/1damages-colombia.pdf - last access 31 May 2024), para. 7.

[47] For example, Article 26(3) of the 2015 Model BIT of India, which states that "[f]or the calculation of monetary damages, the Tribunal shall also reduce the damages to take into account any restitution of property or repeal or modification of the measure, or other mitigating factors". These "mitigating factors" are described in a footnote and include "current and past use of the investment, the history of its acquisition and purpose, compensation received by the investor from other sources, any unremedied harm or damage that the investor has caused to the environment or local community or other relevant considerations regarding the need to balance public interest and the interests of the investor." See also Article 21(2) of the African Union's AfCFTA Protocol on Investments.

[48] Submission by Burkina Faso (A/CN.9/WG.III/WP.199), para. 9.

other words, the examples mentioned above seemingly suggest that, when the circumstances of the case suggest that the amount of damages duly calculated by the tribunal is excessive, it should be equitably reduced to a "fair" amount. Thus construed, the "contextual circumstances" invoked by some States appear to advocate for an increased reliance by arbitrators on equitable considerations to reduce the compensation awarded to investors. If this is the case, a call for equity may be understandable, but it does raise some issues.

On a preliminary basis, it must be noted that both "broader" contextual factors and equitable considerations are already part and parcel of the *quantum* phase of arbitration proceedings. Indeed, as illustrated above, tribunals consider (or should consider) the specific circumstances of each investment when choosing the most appropriate valuation method. Furthermore, the overall context in which the investment was made is also often factored into the calculations of the amount of compensation. This is well-represented by the so-called "country risk premium" in the DCF methodology, which considers the political and economic situation of the host State to calculate a discount rate that is applied to the projected cash flows, reducing their value.[49] Although these country risk premia have been applied with some inconsistency in the past – and particularly in a stream of cases concerning Venezuela –,[50] recent arbitral practice is developing a more consistent approach, which relies, for example, on third-party calculations.[51]

As for equitable considerations, although it is a notion that escapes exact definitions,[52] but it has been frequently applied by international courts and tribunals,[53] also in the context of investor-State proceedings.[54] Notably, equity or equitable

[49] For an overview of the topic, see, *inter alia*, James Searby, "Measuring Country Risk in International Arbitration", in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, ed. Christina L. Beharry (Brill, 2018), 231-261.

[50] Bonnitcha et al., "Damages and ISDS", 227; Elrifai, "Equity-based Discretion", 850. But see also Marboe, "Calculation of Compensation and Damages", 5.179, who argues that such apparent inconsistencies were justified by the specificities of the cases.

[51] For example, in IC Power v. Peru the tribunal referred to the estimates published by Prof. Aswath Damodaran to calculate the country risk premium of Peru (these figures, regularly updated, are available at https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html - last access 21 May 2024) – see *IC Power Ltd. and Kenon Holdings Ltd. v. Peru* (ICSID case no. ARB/19/19), Decision on the Requests for Rectification and Clarification, 3 May 2024, para. 44.

[52] Emmannuel Giakoumakis, "A Riddle Wrapped in a Mystery Inside an Enigma - Equitable Considerations in the Assessment of Damages by Investment Tribunals", in *Custom and its Interpretation in International Investment Law*, ed. Panos Merkouris, Andreas Kilick, José Manuel Álvarez-Zarate, Maciej Żenkiewicz (Cambridge University Press, 2024), pp. 179-210. See also Francesco Francioni, "Equity in International Law" (last updated November 2020), in *Max Planck Encyclopedia of Public International Law,* ed. Anne Peters, Rüdiger Wolfrum (Oxford University Press, 2008-). In case law, see International Court of Justice, *North Sea Continental Shelf*, Judgment, 20 February 1969, para. 88; *Adem Dogan v. Turkmenistan* (ICSID case no. ARB/09/9 - Annulment Proceeding), Decision on Annulment, 15 January 2016, paras. 99-100.

[53] See, *inter alia*: International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda),* Judgment, Reparations, 9 February 2022, para. 106; International Court of Justice, *Certain Activities Carried Out by Nicaragua in the Border Area (Costa Rica v. Nicaragua)*, Judgment, 2 February 2018, para. 35; Iran-United States Claims Tribunal, *Islamic Republic of Iran v. United States of America* (case no. A15 (IV)/A24), Award, 2 July 2014, para. 230.

[54] See, *inter alia*: *Gold Reserve Inc. v. Bolivarian Republic of Venezuela* (ICSID case no. ARB(AF)/09/1), Award, 22 September 2014, para. 686; *Total S.A. v. Argentina* (ICSID case no. ARB/04/1), Award, 27 November 2013, fn 39; *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States* (ICSID case no. ARF(AF)/00/2), Award, 29 May 2003, para. 190.

considerations have been often invoked as a tool to determine damages when damage and causality were certain, but the evidence of the case did not allow the adjudicators to calculate an exact figure for compensation.[55] Ultimately, also the choice of the appropriate valuation methodology and the ultimate compensation awarded in favour of the parties is an exercise of discretion by arbitrators that relies on their equitable understanding of the specificities of each case.[56]

However, as said, in the suggestions presented by States in the context of Working Group III "contextual" and "equitable" considerations appear to be invoked to reduce an amount based on a seemingly correct figure. In other words, these would operate at the last stage of the *quantum* phase to cap compensation. If this is so, then the approach raises some fundamental questions.

First, thus interpreted, the approach would appear to represent a derogation to the principle of full reparation.[57] In fact, this concern has been stressed by some tribunals, which rejected the request to apply equitable considerations as a cap to damages.[58] Some adjudicators have expressed a certain degree of sympathy with the idea,[59] but case law

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[55] Marboe "Calculation of Compensation", 3.348. Resort to equitable considerations can also related to other aspects.

[56] *American Manufacturing and Trading v. Zaire* (ICSID case no. ARB/93/1), Award, 21 February 1997, para. 7.02. On this topic, see also Elrifai, "Equity-Based Discretion", 854-855. On a more general level, the tribunal in ADC v. Hungary famously noted that "the assessment of damages is not a science. True it is that the experts use a variety of methodologies and tools in order to attempt to arrive at the correct figure. But at the end of the day, the Tribunal can stand back and look at the work product and arrive at a figure with which it is comfortable *in all the circumstances of the case*" (*ADC Affiliate Limited and ADC & ADMC Management Limited v. Hungary* (ICSID case no. ARB/03/16), Award, 2 October 2006, para. 521).

[57] Indeed, as highlighted by Giakoumakis, equitable considerations cannot derogate *in toto* from full reparation, lest running the risk of operating as a circumstance precluding wrongfulness (Giakoumakis, "A Riddle", 203). In the same vein, Francioni asks: "[i]f, as often occurs, the circumstances of the case dictate that application of equity must lead to the determination of an amount of compensation that is less than the market value of the property taken, is this equity *contra legem* or equity within the law?" (Francioni, "Equity in International Law", para. 18).

[58] "The Tribunal agrees with Claimants that, absent an applicable treaty provision on damages, the *Chorzów Factory* 'full compensation' standard is the appropriate starting point for quantum assessment. The Tribunal finds that this general standard applies to FET, umbrella clause, and other treaty violations, and is therefore not limited to cases of expropriation. The Tribunal does not agree that the words, 'as far as possible', in any way suggest that a tribunal should weigh various contextual or equitable factors to award damages below the level of full compensation. On the contrary, that phrase means that a tribunal must do whatever it can to ensure that full compensation is granted and the injured party is made whole." (*Greentech v. Italy* (SCC case no. 2015/095), Final Award, 23 December 2018, para. 548). See also *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina* (ICSID case no. ARB/97/3), Award, 20 August 2007, paras. 8.4.1 ff. It is interesting to note that also the treaty underlying the *Tethyan Copper v. Pakistan* arbitration referred to "equitable principles" in the calculation of compensation – albeit for lawful expropriations (Article 7(2) of the 1998 Australia-Pakistan BIT). The tribunal, however, despite finding that the standard to be applied in case of an unlawful expropriations was in substance the same, eventually did not rule on the potential application of that expression in the *quantum* phase (*Tethyan Copper v. Pakistan*, Award, paras. 276-281).

[59] For example, in PPC v. Iran, in which the US-Iran Claims Tribunal stated that "the determination of value by a tribunal must take into account all relevant circumstances, including equitable considerations" (*Phillips Petroleum Co. Iran v. Iran and the National Iranian Oil Co.* (1989) 21 IUSCT 79, para. 112). See also *American Independent Oil Company v. Kuwait*, Final Award, 23 June 1979, para. 78; *Himpurna California Energy Ltd. v PT. (Persero) Perusahaan Listruik Negara*, Final Award, 4 May 1999, paras. 237, 318, 371, 373, and 375 (although the tribunal eventually rejected the claim based on the abuse of rights doctrine). (*CME Czech Republic B.V. v. Czech Republic*, Separate Opinion on the Issues at the Quantum Phase of CME v. Czech Republic by Ian Brownlie, 14 March 2003, paras. 77–78. Marzal (in "Quantum", 266) also refers

in that direction remains very scarce. In the context of Working Group III, this could prove a problematic aspect, since reports suggest that there is wide consensus that the reform work should not depart from the full reparation principle.[60]

This does not mean that the principle is unassailable, but rather that different venues might be more appropriate to introduce a different standard of compensation, particularly treaty practice.[61] In fact, the principle of full reparation is of a dispositive nature,[62] and some BITs and model BITs have already introduced provisions that – implicitly or explicitly – depart from that standard,[63] also by introducing indications referring to contextual factors.[64] India's 2015 model BIT, for example, urges tribunals to consider "the need to balance the public interest and the interests of the investor" in the quantification of damages.[65] How these provisions will be interpreted is a different matter, which leads to a different concern.

Indeed, a second issue with the proposed use of equitable considerations is that – as opposed to Draft Provision 23, which seeks to introduce guidelines to achieve more objective assessments – it introduces a wider margin of discretion in favour of adjudicators. The underlying *rationale* of using open-textured clauses is understandable,

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to the *Starrett Housing v. Iran*, although in that case the tribunal appears to have referred to equitable considerations only with respect to its discretion in the approximation of calculations in the absence of clear evidence (Iran-US Claims Tribunal, *Starrett Housing Corporation et al. v. Iran et al.* (IUSCT case no. 24), Final Award, 14 August 1987, para. 339).

[60] *Summary of the intersessional meeting on investor-State dispute settlement (ISDS) reform submitted by the Government of Belgium* (A/CN.9/WG.III/WP.242), 28 March 2024, para. 46; *Report of Working Group III (Investor State Dispute Settlement Reform) on the work of its forty sixth session (Vienna, 9 13 October 2023)* (A/CN.9/1160), 27 October 2023, paras. 102 and 115; joint submission by CCSI, IIED, IISD and the South Centre of 21 May 2024 (available at https://uncitral.un.org//sites/uncitral.un.org/files/media-documents/uncitral/ccsi_iied_iisd_sc_submission_-_may_2024.pdf - last access 31 May 2024), p. 4; submission of the European Union (available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/comments_from_the_eu_and_its_ms_wp.231.pdf - last access 31 May 2024), 24.

[61] Also, Bonnitcha, Langford, Alvarez and Behn recognise that "fundamental reform to the principles governing compensation for expropriation would probably require express modification of the underlying treaties." (Bonnitcha et al., "Damages and ISDS Reform", 240).

[62] Martins Paparinskis, "Crippling Compensation in the International Law Comission and Investor-State Arbitration", *ICSID Review*, vol. 37, no. 1-2 (2022), 308.

[63] See, e.g., Article 6 of the Mozambique-Netherlands bilateral investment treaty of 18 December 2001, or Article 4 of the Germany-Singapore bilateral investment treaty of 1 October 1973.

[64] See, e.g., Article 21(2) of the Iran-Slovakia bilateral investment treaty of 19 January 2016, which states: "Any award of damages shall be determined in accordance with the generally recognized international principles of valuation and taking into account, inter alia, an equitable balance between the public interest and interest of those affected, the purpose of the measure, the current and past use of the property, the history of its acquisition, the amount of capital invested, depreciation, duration as a going concern of the undertaking, its record of profitability, capital already repatriated, replacement value and other relevant factors. Compensation shall neither include losses which are not actually incurred nor probable or unreal profits. Compensation may be adjusted to reflect aggravating conduct by an investor or conduct that does not seek to mitigate damages. In establishing the just quantum of damages, the tribunal shall base its decision on a comparison of multiple valuation methods, where appropriate."

[65] Article 26(3): "[f]or the calculation of monetary damages, the Tribunal shall also reduce the damages to take into account any restitution of property or repeal or modification of the measure, or other mitigating factors". These "mitigating factors" are described in a footnote and include "current and past use of the investment, the history of its acquisition and purpose, compensation received by the investor from other sources, any unremedied harm or damage that the investor has caused to the environment or local community or other relevant considerations regarding the need to balance public interest and the interests of the investor."

since equity necessarily depends on the circumstances of the case, and it is therefore necessary to give more leeway to tribunals. Yet, this hardly goes along with other perceived issues with the current ISDS system, namely (in)consistency and (un)predictability.[66] In this respect, one could also wonder whether more discretion would actually lead to a reduction in "excessive" damages. In the end, as argued by Francioni, one can legitimately wonder "whether it is possible to assume the existence of a common sense of justice and fairness in a society that is culturally and politically divided as the international society is today."[67] States appear confident that tribunals will have a clear understanding of what is a fair calculation of damages, but this assumption may be contradicted in practice by the different opinions of arbitrators. For example, it is unclear what is the standard that tribunals would apply to strike a proper balance between public and private interests in the definition of the *quantum*, or the to define economic value to be attached to those interests.

This leads to the third issue of the claim for an increased resort to "contextual" or "equitable" elements, which is whether the last stage of the *quantum* phase is the appropriate phase of the proceedings to tackle these issues.[68] Turning again to the example of the balancing of interest, this exercise pertains more to whether compensation is due at all, e.g. when evaluating the proportionality of a measure under the FET standard,[69] for the application of a non-precluded measures clause, or even a circumstance precluding wrongfulness. The same goes for the potential impact of the investment on the environment, which may well form the object of a counterclaim, or a ground to invoke contributory negligence. More generally, there are many tools for States to try and prevent an adverse decision on liability or to limit compensation.[70] If all the State's arguments fail, it is unclear why they should be revived as an (unpredictable) tool of last resort to cap compensation,[71] an option that may lead investors to perceive a certain element of "unfairness" in the system – although, in the end, it is true that States remain masters of their own treaties and of the balance of interests within the systems they create.

In conclusion, it is possible to argue that Working Paper 231 rightly excluded any reference to contextual elements in the sense described above. This does not mean that the topic should be set aside for good. Still, the problematic aspects raised above make it challenging to assess it in the context of Working Group III and should be rather addressed through treaty drafting, if States perceive that international investment law calls for an increase resort to contextual and equitable considerations beyond the tools already available.

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[66] Elrifai, "Equity-Based Discretion", 872.
[67] Francioni, "Equity in International Law", para. 2.
[68] Elrifai "Equity-Based Discretion", 869 ff.
[69] E.g. *Electrabel S.A. v. Hungary* (ICSID case no. ARB/07/19), Award, 25 November 2015, paras.165 and 179.
[70] B. Sabahu, K. Duggal, and N. Birch, "Principles Limiting the Amount of Compensation", in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, ed. C.L. Beharry (Brill, 2018), 325-346.
[71] In this respect, see the decision of the tribunal in Santa Elena v. Costa Rica, which held (although in the context of a legitimate expropriation) that if a tribunal concludes on the merits that compensation is due, then the reasons underlying the adoption of the challenged measures have no bearing on the decision on *quantum* (*Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica* (ICSID case no. ARB/96/1),Final Award, 17 February 2000, para. 71).

5. The financial capacity of the host State

The considerations reported above apply also to the broader contextual factor most frequently invoked within the context of Working Group III, which relates to the host State's financial situation. As reported above, this item was included under the potential "areas of work" identified by the UNCITRAL Secretariat in its Note on Damages, which – drawing from the works of Martins Paparinskis –[72] referred to "the host States' ability to pay for the amounts awarded" and "the potential 'crippling effect' of an award on the respondent State" as examples of contextual factors that may play a role in the reduction of "excessive" damages.[73]

As noted above, so far the issue has not been addressed in Working Paper 231. As already mentioned, this exclusion appears justified due to the limited scope of the ISDS reform process and the problems inherent with the practical application of this circumstance to cap damages awards. Yet, this should not lead to underestimating the importance of the topic on a more general level. The issue of potentially crippling awards is indeed far from theoretical. To take one example, damages claimed against Pakistan in recent investor-State proceedings may likely exceed 6% of the country's net federal budget for 2023-2024,[74] in a situation where the State is scarred by multiple non-international armed conflicts,[75] precarious economic conditions,[76] and record poverty rates.[77] As acknowledged also by advocates of a case against crippling compensation, however, the topic is not an easy one to tackle. Most of the problems associated with it are common to the issues presented above for other contextual factors and equitable considerations, to which considerations relating to the economic capacity of the host State appear interlinked.[78]

The first obstacle is represented, once again, by the principle of full reparation. As highlighted by Paparinksis, the final version of ARSIWA has clearly ruled out an

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[72] Martins Paparinskis, *"Crippling Compensation in the International Law Comission and Investor-State Arbitration", ICSID Review, vol. 37, no. 1-2 (2022), 289-312*; Paparinskis, "A Case Against Crippling Compensation in International Law of State Responsibility", 1246-1286. See also G. Prieto "Awarding Damages in Times of Armed Conflict: An Emerging Standard of 'Economic Capacity' for the Host State", in *International Investment Law and the Law of Armed Conflict*, ed. Katia Fach Gómez, Anastasios Gourgourinis, Catharine Titi (Springer, 2019), 363-383.

[73] Note on Damages, para. 69.

[74] As of May 2024, the state was facing at least one ICSID case, for a reported value of over 750 million USD (https://www.iareporter.com/articles/turkish-contractor-bayindir-lodges-a-new-claim-against-pakistan-12-years-after-an-icsid-tribunal-rejected-an-earlier-bit-claim-between-the-parties/), while the *Tethyan Copper v. Pakistan* and *Tethyan Copper v. Balochistan* cases were eventually settled for 900 million USD (https://www.iareporter.com/articles/following-approval-by-pakistans-supreme-court-parties-finalise-settlement-of-tethyan-copper-dispute/). The State's federal budget for 2023-2024 was estimated at 14,460 billion Rupees (approximately 52 billion USD), almost half of which were earmarked to pay interest on foreign and domestic debt (https://www.finance.gov.pk/budget/Budget_2023_24/Speech_english_2023_24.pdf - last access 31 May 2024).

[75] For an overview of the ongoing non-international armed conflicts see: https://www.rulac.org/browse/conflicts/non-international-armed-conflicts-in-pakistan (last access 31 May 2024).

[76] S. Rana, "Pakistan's Existential Economic Crisis", US Institute of Peace, 6 April 2023 (https://www.usip.org/publications/2023/04/pakistans-existential-economic-crisis - last access 31 May 2024).

[77] According to World Bank data from April 2023, 37.2% of the population of Pakistan lives below the poverty line (https://databankfiles.worldbank.org/public/ddpext_download/poverty/987B9C90-CB9F-4D93-AE8C-750588BF00QA/current/Global_POVEQ_PAK.pdf - last access 31 May 2024).

[78] On the relation between the two, see Paparinskis, "Crippling Compensation", 297 and 308.

exception to the full reparation principle reflected under Article 31 for cases in which a reparation order had a crippling effect on the economy of the State concerned.[79] Most importantly, States have not challenged this position after 2001, and continue to support the unrestricted application of the full reparation principle in various fora,[80] including investor-State proceedings,[81] despite the opposing views that emerged at the time of the discussions that led to the adoption of ARSIWA.[82]

There are, however, some (rare) exceptions. An interesting one is represented by the submissions of Uganda in the case initiated by the Democratic Republic of the Congo before the International Court of Justice, in which the respondent State had claimed that the compensation sought by the appellant (exceeding 13 billion USD) could have had "ruinous economic consequences" on the economy of Uganda and the well-being of its people.[83] Ultimately, however, the Court – albeit acknowledging the potential relevance of the economic capacity of the respondent in its quantification of damages –[84] did not take any position on the matter, considering that the amount eventually awarded (325 million USD, to be paid in five annual instalments) remained within Uganda's financial capacity.[85]

In the context of investor-State proceedings, Brownlie also expressed criticism towards potential crippling compensations in his dissenting opinion to the *CME v. Czech Republic* award.[86] After that, however, the issue appears to have disappeared from the

[79] Paparinskis, "A Case Against Crippling Compensation", 1253 ff.

[80] *Ibid.,* 1266.

[81] Paparinskis, "Crippling Compensation", 302-303 (suggesting different possible reasons for this silence).

[82] Indeed, an earlier version of the draft articles read: "In no case shall reparation result in depriving the population of a State of its own means of subsistence" (International Law Commission, *Draft articles on State responsibility* (A/CN.4/SER.A/1996/Add.1 Part 2), Yearbook of the International Law Commission 1996, Volume II, Part 2, 63). For an overview of the debates that preceded the adoption of the articles in their current form, see Papaparinkis, "Crippling Compensation", 295 ff.

[83] International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)*, Oral Proceedings, Verbatim Record (2021/7), 22 April 2021, 17-18, paras. 24-29; International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)*, Oral Proceedings, Verbatim Record (2021/12), 30 April 2021, 67, paras. 24-26.

[84] International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)*, Judgment, Reparations, 9 February 2022, para. 110. In the context of interstate proceedings, see also *The Duzgit Integrity Arbitration (Malta v. São Tomé and Príncipe)* (PCA case no. 2014-07), Dissenting Opinion of Judge Kateka on the Award on Reparation, 18 December 2019, paras. 25-26.

[85] "The Court is satisfied that the total sum awarded, and the terms of payment, remain within the capacity of Uganda to pay. Therefore, the Court does not need to consider the question whether, in determining the amount of compensation, account should be taken of the financial burden imposed on the responsible State, given its economic condition" (International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)*, Judgment, Reparations, 9 February 2022, para. 407).

[86] "[…] it is simply unacceptable to insist that the subject-matter [of the BIT] is exclusively 'commercial' in character or that the interests in issue are, more or less, only those of the investor. Such an approach involves setting aside a number of essential elements in the Treaty relation. The first element is the significance of the fact that the Respondent is a sovereign State, which is responsible for the well-being of its people. This is not to confer a privilege on the Czech Republic but only to recognise its special character and responsibilities. […] The resources of a country, its human and natural resources, are a given: they are necessarily fixed. […] Even States which have been held responsible for wars of aggression and crimes against humanity are not subjected to economic ruin […] It would be strange indeed, if the outcome of acceptance of a bilateral investment treaty took the form of liabilities likely to entail catastrophic repercussions for the livelihood and economic well-being of the population of the Czech Republic." (*CME Czech Republic B.V. v. Czech Republic*, Separate Opinion on the Issues at the Quantum Phase of CME v.

debate, thus cementing the perception that full reparation remains a rigid standard in the absence of explicit derogations.

Nevertheless, there can be different approaches to the matter, which do not require amending the full reparation principle.[87] For example, the Eritrea-Ethiopia Claims Commission ("EECC"), in an often-cited pair of awards,[88] linked the potential necessity to cap its decision on damages to the parties' human rights obligations.[89] This is an interesting approach, which calls for a potential application of the principle of systemic integration in the interpretation of the laws on State responsibility.[90] Since it remains an underexplored option, States may be willing to test it in their legal arguments. Another issue linked with the proposed approach to crippling compensation is connected, as in the case of more general equitable considerations, to the discretion granted to tribunals in deciding "how much is too much". In fact, in light of the scarcity of case law over the matter, it is hard to draw a line between reasonable and crippling compensation, and different adjudicators may apply different standards.[91] The EECC suggested that capping damages could have been warranted if the Commission were to fully uphold Ethiopia's claims, amounting to over three times Eritrea's 2005 GDP.[92] Yet, if a tribunal were to set the bar that high, the application of a "crippling compensation exception" would be hardly foreseeable.[93] Moreover, it is unclear how arbitrators would approach a situation in which the crippling effect on the host State's economy derives from multiple proceedings initiated by different actors and/or under different instruments.[94]

Czech Republic by Ian Brownlie, 14 March 2003, paras. 74-78). It is worth noting that the underlying agreement referred to 'just compensation', an expression that the dissenting arbitrator specifically distinguished from the one of fair market value. (*ibid.,* paras. 23-24)

[87] Besides the one analysed here, it is worth mentioning the position of Marzal, who questions whether a cap to damages depending on the economic situation of the host State could no fall within a different understanding of full reparation: "since full compensation/reparation is not an objective measure, there is no obvious reason why tribunals should disregard equitable considerations within their calculations, or see this question as entirely insulated from politics and discretionary judgment. It cannot therefore be ruled out that tribunals equitably consider, *inter alia*, the impact of the award on the finances of the State, the history of the investor's conduct, the public policy *rationale* of the measure in breach or the nature of that breach [footnote omitted] – not as exceptions to the standard of full compensation/reparation, but as relevant factors to the determination of what counts as compensable harm (i.e. that which needs to be 'fully' compensated)." (Marzal, "Quantum", 296).

[88] Eritrea-Ethiopia Claims Commission, Final Award, Eritrea's Damages Claims, Decision of 17 August 2009, UN Reports of International Arbitral Awards, Volume XXVI, 521-525, paras. 18–27; Eritrea-Ethiopia Claims Commission, Final Award, Ethiopia's Damages Claims, Decision of 17 August 2009, UN Reports of International Arbitral Awards, Volume XXVI, 649-652, paras 18–27.

[89] *Ibid*.

[90] Prieto, "Awarding Damages", 379.

[91] Indeed, Paparinskis notes that, even if the exception were to be introduced, State would have to "be tolerant of practical challenges and considerable diversity in individual instances of application during the initial – quite possible lengthy – stages of that process." (Paparinskis, "A Case Against Crippling Compensation", 1282). See also Prieto, "Awarding Damages", 375.

[92] Eritrea-Ethiopia Claims Commission, Final Award, Ethiopia's Damages Claims, Decision of 17 August 2009, para. 18.

[93] Especially if a tribunal considers, as the International Court of Justice did in the Armed Activities case, that the amount can be paid in instalments (International Court of Justice, *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)*, Judgment, Reparations, 9 February 2022, para. 406).

[94] Prieto, "Awarding Damages", 379.

Finally, one can wonder again if the financial situation of the host State might not be addressed as a relevant factor in other stages of the proceedings, within existing valuation methodologies,[95] or even at the enforcement stage (although this inevitably poses the issue of potentially fragmented outcomes).[96]

Against these concerns, it is legitimate to have doubts about whether the issue may re-enter the Working Group III agenda. Yet, the argument may (and probably should) be raised in other contexts and/or through other tools. In this respect, one could wonder whether the States' call within Working Group III is not, after all, just an attempt to follow Paparinskis suggestion and start challenging the current customary rule in all possible venues.[97]

6. Conclusions

The ISDS reform process within Working Group III is still ongoing, and it may still lead to many possible outcomes, particularly in relation to the current discussions concerning potential provisions on procedural and cross-cutting issues. This contribution tried to address one specific item that was raised in those discussions, identifying the strengths and weaknesses of some proposals raised by delegations and the UNCITRAL Secretariat to solve a perceived "unfairness" in the calculation of damages concerning the high amounts awarded in favour of investors.

As illustrated, the current approach to the topic in arbitration practice is characterised by a clear reference to the full reparation principle but presents some material inconsistencies relating to the adoption of appropriate valuation criteria for the calculation of compensation and damages. The draft provision contained in Working Paper 231 represents an important point of departure to tackle this second aspect, by elaborating clear guidelines to guide parties and arbitrators. Some items may deserve further consideration, and delegations will have to discuss more thoroughly the more appropriate instrument to contain these rules, but they have the potential to become a precious tool to address most of the concerns of the stakeholders involved.

Conversely, the requests of certain States to address the potential role of contextual factors and equitable considerations in the context of Working Group III raise more questions, and it has been probably rightly excluded (so far) from Working Paper

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[95] For example, Marboe argues that the financial situation of Argentina had been duly taken into account in the counterfactual scenario that led to the quantification of damages, leading her to conclude that "economic realities, including financial crises, generally are and should be reflected in the calculation of compensation and damages. For this purpose, it is not necessary to rely on equitable considerations. While in cases of temporary difficulty the deferral of payment or payment in instalments can be helpful, the appropriate application of the respective valuation methods may well reflect various kinds of macroeconomic fluctuations. A comparison with the hypothetical financial situation of the victim of the unlawful act could and should, for example, reflect the economic crises which would have reduced his or her financial situation anyway. Furthermore, an appropriate reflection of the risk is included in several economic valuation methods" (Marboe, "Calculating Compensation", 3.372-3.373). It can be thus inferred that a more consistent use of country risk premia and existing methodologies in general might already provide appropriate redress to the matter analysed in this section.

[96] Paparinksis, referring to the works of Crawford, suggests that the State may invoke a situation of necessity as circumstance precluding wrongfulness in relation to the secondary obligation of reparation (Paparinskis, "A Case Against Crippling Compensation", 1255), although he highlights the difficulties potentially associated with this defence (*ibid.,* 1258-1259). See also Paparinskis, "Crippling Compensation", 305.

[97] Paparinskis, "A Case Against Crippling Compensation", 1279, 1285-1286.

231. There are three main reasons for this.

First, introducing a provision limiting compensation on the basis of contextual or equitable considerations may fall outside the scope of a procedural reform process, and even be counterproductive. In fact, such a limitation would appear to run against the full reparation principle, thus requiring a change in the relevant secondary rules, which should rather occur through treaty practice, [98] or at the level of customary law. In addition, even if it were to be introduced, it may increase the risk of inconsistent outcomes, given the wide margins of discretion it would inevitably grant to arbitrators.

Second, a provision dealing with these issues may be unnecessary. Contextual and equitable factors are already part and parcel of the adjudication process, even in the calculation of damages, and elaborating written provisions would pose serious hurdles in reaching a common definition of these notions. Furthermore, although these elements are currently not applied as a cap to (what is perceived as) excessive compensation due to the limits seemingly posed by the full reparation principle, there may be other solutions to introduce the argument in the proceedings, such as through systemic integration.[99]

Finally, there is a broader question relating to the appropriateness of a cap on damages. One should not forget that the matter at hand rests on the premise that a State has breached an international obligation. States are free of course to determine the consequences of these breaches, but one can reasonably ask if introducing broad exceptions to the full reparation principle does not have the potential to turn investment obligations into an empty shell, discourage investments, or even set an incentive for non-compliance.[100] The concerns relating to crippling compensation are well-founded – and probably States should raise the topic in a more structured manner, possibly before an adverse award –,[101] but compliance with the primary rules should always be a desirable priority.

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[98] See notes n. 47, 64, and 65 above.

[99] See Section 5 above. Another approach, not explored here for reasons of space, is to consider equity as part a general principle of law for the purposes of Article 38(1)(c) of the Statute of the International Court of Justice (Francioni, "Equity in International Law", para. 5; Prieto, "Awarding Damages", 378), and thus as a "relevant rule of international law" to consider in the interpretation of the full reparation principle.

[100] *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-third session (Vienna, 5–16 September 2022)* (A/CN.9/1124), 7 October 2022, para. 97; W. Herfried, A. San Román, I. Marboe, "Expert Comments on Assessment of Damages and Compensation (UNCITRAL - Note by the Secretariat of September 2021)", *Transnational Dispute Management*, no. 5 (2022), 27; Paparinskis, "A Case Against Crippling Compensation", 1263.

[101] In fact, at the annulment stage the argument has so far proved rather unsuccessful: *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Venezuela* (ICSID case no. ARB/07/30), Decision on the Applicant's Request to continue the Stay of Enforcement of the Award, 2 November 2020, para 51-54; *Tethyan Copper Company Pty Limited v. Pakistan* (ICSID case no. ARB/12/1 – annulment proceedings), Decision on Stay of Enforcement of the Award, 17 September 2020, 62 and 151 ff.; *Perenco Ecuador Limited v. Ecuador* (ICSID case no. ARB/08/6 – annulment proceedings), Decision on Stay of Enforcement of the Award, 21 February 2020, paras. 27, 28, and 76.

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