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International Investment Agreements

Compensation and Damages in Investor-State Dispute Settlement Proceedings

HIGHLIGHTS

- Damages awards are growing. Tribunals have awarded sums exceeding US dollars 100 million in more than a quarter of all investor-State dispute settlement (ISDS) cases won by investors.
- Old-generation international investment agreements (IIAs) do not sufficiently define the compensation rules for treaty breaches. In the absence of specific treaty provisions, the issue is governed by customary international law which leaves scope for ISDS tribunals' interpretation.
- Different techniques to determine the amount of compensation exist. ISDS tribunals often rely on those that use a wide range of speculative assumptions about future profits and risks.
- In many recent IIAs, States seek to counter the trend of excessive awards. Treaty parties can specify ISDS tribunals' approaches to compensation, for example, by limiting the award of hypothetical future profits, prescribing guidance on valuation techniques, or developing techniques to disincentivize excessive claims.
- Ninety-eight per cent of ISDS cases are based on old-generation IIAs that typically lack any clear guidance on compensation. Reforming these treaties is crucial to reduce the risk of excessively large awards.

Average ISDS award size
(million USD)

Source: UNCTAD ISDS Navigator database, accessed 15 August 2024.

Introduction

International investment agreements (IIAs) form a regime consisting of over 2,600 treaties that are currently in force. Approximately 90 per cent of these are old-generation agreements, concluded in the 1980s, 1990s and 2000s. They generally contain unrefined treaty standards and grant broad access to investor–State dispute settlement (ISDS) in the form of binding international arbitration. By the end of 2023, investor claimants had brought at least 1,332 known treaty-based ISDS cases.[1]

Traditionally, IIAs with ISDS provisions allow arbitral tribunals to order the respondent State to compensate the investor in the form of monetary damages in case of breach. The amounts awarded in ISDS proceedings were comparatively low in the 1990s and the early 2000s when the first ISDS cases were concluded. They have risen significantly over time, especially since 2010. Large damages awards, at times reaching billions of United States dollars (USD), may have serious implications on State's public finances. They can also contribute to further indebtedness of countries, in particular developing and least developed ones (UNCTAD, 2024a). Concerns about large compensation awards have been raised repeatedly (UNCTAD, 2015, IISD, 2020, Aisbett, Bonnitcha, 2021, Paparinskis, 2022). The increasing amounts of damages awarded by arbitral tribunals are, hence, of significant importance to States, investors, and other stakeholders.

The legal principles governing the assessment of compensation and damages in ISDS cases and their application by arbitral tribunals thus have been subject to increased scrutiny in recent years and merit the attention of treaty negotiators. While often claimed to be technical, the rules of customary international law governing compensation and damages in ISDS are not more complex than other areas of investment policymaking. ISDS practice, however, shows divergence from the way these principles are applied by other international courts and tribunals. In their treaties, States may provide more specific guidance as to the application of customary international law as well as craft special rules on compensation and damages.

The following section empirically shows the trend of increasing amounts awarded to foreign investors. The section thereafter introduces the basic principles that govern the calculation of damages and compensation, as well as the methods relied on by ISDS tribunals in doing so. The last section highlights modern IIA approaches adopted in existing treaties to guide arbitral tribunals in determining the amount of damages. It illustrates possibilities of doing so while staying within the bounds of the customary standard of "full reparation".

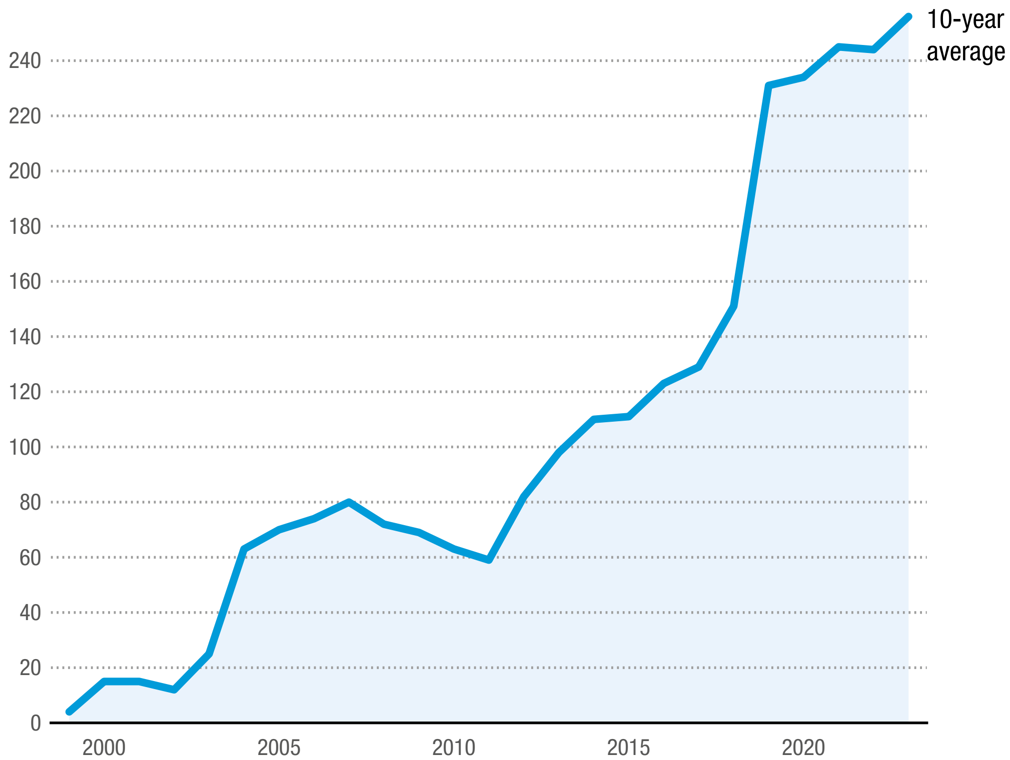
Trends in ISDS damages awards

ISDS damages awards often involve substantial sums, consisting of a principal amount and interest (pre-award and post-award interest). They may cover direct losses (e.g. lost tangible or intangible property of the investor) and the loss of anticipated future profits.

Past awards range between hundreds of thousands and billions of US dollars. Figure 1 displays a rolling average of monetary damages awarded in treaty-based ISDS proceedings over time. Whereas tribunals ordered on average payment of USD 68 million between 2000 and 2009, this number nearly quadrupled to over USD 250 million in the past decade. This does not include the interest due on the principal amounts awarded, which can be substantial (box 1).

[1] ISDS cases in this IIA Issues Note refer to known treaty-based ISDS cases. This does not include cases exclusively based on investment contracts or domestic laws unless specified otherwise.

Figure 1
ISDS damages awards are growing
Ten-year rolling average of damages awards in treaty-based ISDS proceedings



Source: UNCTAD ISDS Navigator database, accessed 15 August 2024.

Note: Principal amounts awarded in cases decided in favour of the investor (n=256), excluding pre-award and post-award interest. The graph excludes the three *Yukos* cases (*Hulley Enterprises v. Russia*, *Yukos Universal v. Russia*, *Veteran Petroleum v. Russia*); the combined 50 billion USD awards are outliers that would significantly increase the average award size.

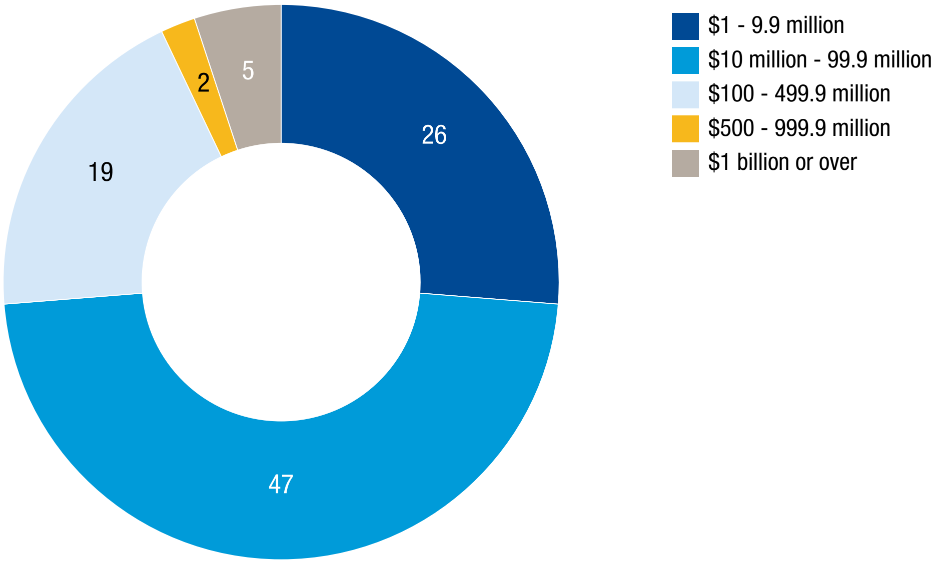
There is no typical award size. By the end of 2023, tribunals awarded damages in excess of USD 100 million in more than a quarter of ISDS cases won by investors (figure 2). One in twenty cases resulted in an award larger than USD 1 billion. Over the years, several particularly large ISDS awards have attracted attention, in particular due to their impact on public finances. The *Tethyan Copper v. Pakistan* case, for example, resulted in an award against Pakistan of over USD 4 billion. The country had negotiated a similarly sized arrangement with the International Monetary Fund just weeks prior (IMF, 2019). In a recent contract-based claim, an ICSID tribunal awarded over USD 1 billion against South Sudan, approximately 15 per cent of the least developed country's annual GDP. Other large awards include cases against Egypt, Ecuador and Venezuela.

Even when individual claims are comparatively small, they can still heavily impact governments when cases form part of a litigation wave – the phenomenon where a single measure or a set of measures causes dozens of related disputes. The ongoing Spanish renewables cases illustrate this issue. Investors launched 51 separate arbitral proceedings because of reforms to the country's incentive regime for renewable energy production. Investors claimed altogether over USD 9 billion in the 38 cases for which this information is publicly available. So far, compensation of approximately USD 1.7 billion was collectively awarded by tribunals in 27 cases decided in favour of the investor (ISDS Navigator). Notably, this includes investors who continue to operate investments in the country. By the end of 2023, 15 cases remained pending.

Figure 2

Damages awards exceed USD 100 million in more than a quarter of all cases won by investors

Distribution of damages awards in treaty-based ISDS proceedings
(Percentage)



Source: UNCTAD ISDS Navigator database, accessed 15 August 2024.

Note: Principal amounts awarded in cases decided in favour of the investor (n=259).

Surging amounts of damages cannot be explained by inflation or the increasing size of investment projects alone. Other reasons also contribute to the increase. First, tribunals increasingly rely on discounted cash flow (DCF) valuations (Marzal, 2021), a valuation method that considers estimated future income (box 3). In recent years they have even done so for projects that never became operational in the host State. The *Tethyan Copper v. Pakistan* case is an example where the investor's mine remained in the planning stage, with key aspects as to the fiscal framework governing the project yet to be negotiated. In the recent *Rockhopper v. Italy* case, the investor won almost USD 200 million in damages for a project that never received the necessary operating permits. Both tribunals relied on valuation methods based on estimated future income. However, such valuation methods are considered problematic in a litigation context, especially when there is no reliable track record of profitability (ILC, 2001b, p 103 para 26).

Second, higher awards may partially be driven by the increasingly large amounts claimed. In the decade between 2014 and 2023, the average investor claim in ISDS proceedings stood at USD 1.1 billion, up from approximately USD 400 million in the period between 1996 and 2005 (ISDS Navigator).

Given this practice of imposing increasingly large damages awards, historical numbers provide limited guidance as to the state of the system. The overall financial impact of increasing damages awards is also compounded by the fact that the number of cases has significantly increased over the years (UNCTAD, 2024b).

Box 1
Interest rates in ISDS and IIAs

In past cases, most ISDS tribunals considered that the principle of "full reparation" under international law entails the award of compound interest, as opposed to simple interest (UNCITRAL, 2022, Grisel, 2014, Lakhter, 2024). Tribunals often ordered the interest to run from the date of the breach to the final payment of the award.

Given the lengthy duration of ISDS proceedings and the growing amounts of damages awarded in ISDS, any applicable interest rate may have a significant impact on the total amount due. For example, in the *ConocoPhillips v. Venezuela* case, the tribunal ruled on an expropriation that took place in 2007. It awarded interest of 5.5 per cent compounded annually, for a compensation of USD 8 billion. By the date the final award was issued in 2019, interest amounted to USD 7.5 billion, almost doubling the amount owed by the Respondent State.

ISDS tribunals' approaches on whether to award compound interest and their practice regarding the date at which interest begins to run is not based on a requirement under customary international law. Other courts and tribunals, such as the International Court of Justice (ICJ) or the European Court of Human Rights (ECtHR), among others, typically opt for simple interest and regularly award it only starting from the date of their decision (IISD, 2022). Under IIAs, the expropriation provision of old-generation treaties often requires interest as of the date of expropriation, not specifying whether simple or compound. Other investment protection standards in old-generation IIAs are silent on interest-related issues.

There is also inconsistency related to the interest rates applied by tribunals in the absence of clear treaty guidance (IISD, 2020). With limited or no reasoning, awards rendered in 2023 included pre-award interest rates as low as 1.3 per cent in *Infracapital v. Spain*, and as high as 10.25 per cent in *Nachingwea and others v. Tanzania*.[a] For Spain, this ultimately meant that at the time of rendering the award, almost nine years after the treaty breach, interest increased the total amount due by 12 per cent. In contrast, in the case of Tanzania, a least developed country, interest increased the principal amount of damages by 72 per cent, despite the shorter proceedings (the award was rendered some five years and a half after the breach). The function of interest is to compensate for the time value of a sum of money. As international capital is mobile, the different locations of the investments cannot be used to justify the high variance in interest rates.

As a result of the risks associated with undefined interest rates and the common application of compound interest, several recent IIAs specify that only simple interest is due on any award. They sometimes also provide guidance on the applicable interest rate.[b]

Source: UNCTAD, based on various sources.

[a] In *Infracapital v. Spain*, the interest rate was based on the average yield of the 10-year Spanish sovereign bond (1.29%) and pre-award interest was simple. In *Nachingwea and others v. Tanzania*, the interest rate was based on the USD prime rate as of 1 June 2023 (8.25%), increased by 2 points and pre-award interest was compounded annually.

[b] See e.g. Colombia—Spain BIT (2021), article 12.5 (any damages); Belarus–India BIT (2018), article 5.2; Argentina–UAE BIT (2018), article 6.5; ECOWAS Common Investment Code (2019), article 11.4; AfCFTA Protocol on Investment (2023), article 21.4.

The legal standard that governs the calculation of damages

Old-generation IIAs, on which most ISDS cases continue to be based, do not contain detailed guidance regarding the legal framework that applies to the assessment of compensation and damages for their breach.[2] As a consequence, arbitral tribunals have relied on general rules of customary international law, in particular, the overarching standard of "full reparation." This standard is reflected in Article 31 of the International Law Commission's (ILC) Articles on Responsibility of States for Internationally Wrongful Acts (Articles on State Responsibility) (ILC, 2001a). After introducing the general rule of "full reparation" in the first sub-section, the second sub-section describes its application by ISDS tribunals.

The "full reparation" rule

The Articles on State Responsibility provide that a State is under an obligation to make full reparation for an injury caused by an internationally wrongful act. This includes breaches of international treaties. The Permanent Court of International Justice clarified in its 1928 judgment in the *Chorzow Factory* case that "full reparation" for a breach of international law "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."

The "full reparation" rule encapsulates several core elements that clarify the type of compensable injury and the circumstances that affect the level of compensation. According to the Articles on State Responsibility and its Commentary, the level of compensation and its assessment varies depending on the content of the primary obligation, the behaviour of the parties, as well as a "concern to reach an equitable and acceptable outcome" (ILC, 2001b, p. 100, para 7).

Compensable injury: Compensation aims to offset the damage suffered as a result of the violation of an international rule. It covers financially assessable damage, including, where applicable, ascertainable lost profits. The injury could, for example, be a complete loss of property or contractual rights or a reduction in their value. Two points are worth expanding on regarding the compensable injury: the type of rule that was breached and the assessment of future profits.

First, the application of the customary rule of "full reparation" depends on the primary international law obligation that has been breached, for example, the treaty rule that was violated. The ILC Commentary notes that in situations involving procedural obligations, "full reparation" should not give the injured entity more than it would have been entitled to if the obligation had been performed. Procedural obligations condition the exercise of the substantive powers of a State (ILC, 2001b, p 96, para 3). The due process obligations under the fair and equitable treatment standard in IIAs offer an example of such procedural obligations.

Second, regarding lost profits, the ILC Commentary notes that it is inappropriate to award "compensation for claims with inherently speculative elements" and specifically cautions that the assessment of future profits is vulnerable to commercial and political risks that are often difficult to assess with the necessary level of certainty (ILC, 2001b, p. 104, para 27).

2 The exception is the provision on expropriation which generally provides guidance for calculating compensation as a condition for lawful expropriation by referring to the fair market value of the investment. These IIAs do not provide guidance for breaches of other provisions.

Causation: At the general level, the function of the "full reparation" standard is to re-establish the situation that existed prior to the breach. The ILC Commentary specifies that the compensable injury is only the injury "resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act (ILC, 2001b, p 92, para 9)." More recently, applying the standard of "full reparation", the ICJ stated that compensation must only compensate the injury that has a direct and certain causal nexus with the breach (ICJ, *Armed Activities on the Territory of the Congo*, 9 February 2022, para 94). A corollary is that speculative damage cannot be recovered under the "full reparation" standard.

Duty to mitigate and contributory fault: The standard of "full reparation" also includes the duty to mitigate the damage caused by the breach, as well as the notion of contributory fault, which must be taken into account when assessing the compensation due. This means that international dispute settlement bodies should reduce the amount of damages due to the injured party whenever they consider that party's conduct to have contributed to the injury.

How ISDS tribunals determine damages in practice

The approach to the rule of "full reparation" in ISDS proceedings differs from the practice of other international courts and tribunals (box 2). It does so with respect to key aspects of the rule's application, which tend to lead to higher amounts of damages.

The following example illustrates the consequences of different approaches to the valuation of damages under the "full reparation" standard for the same underlying dispute. The so-called *Yukos* claimants brought three ISDS cases (*Hulley Enterprises v. Russia*, *Yukos Universal v. Russia*, *Veteran Petroleum v. Russia*) and parallel proceedings before the ECtHR. The ISDS tribunals and the ECtHR applied the same compensation standard of "full reparation" to the same set of facts. The ISDS cases collectively awarded approximately USD 50 billion in damages against the Russian Federation. The ECtHR, by contrast, ordered the payment of approximately EUR 1.9 billion (around USD 2.5 billion at historical exchange rates) (ECtHR, *Yukos v Russian Federation*). While far smaller than the ISDS award, in the context of the European Court of Human Rights the USD 2.5 billion compensation was still exceptionally large. Expressed as a percentage of what was claimed by the investor, the ISDS tribunal awarded approximately 44 per cent of the initial claims. In the final judgment of the ECtHR compensation represented less than 5 per cent of what was claimed.

Current ISDS practice often characterises the valuation of the compensable loss as a purely factual determination. This could give the impression that the application of the "full reparation" standard is a mechanical exercise. By contrast, other international courts and tribunals understand that the application of "full reparation" is also guided by legal considerations. (see also ILC, 2001b, p 92, para 10).

Compared to other international courts and tribunals, ISDS tribunals tend to adopt a broad understanding of what constitutes a compensable injury. In the case of a direct expropriation, the fair market value of the expropriated asset generally corresponds to the injury caused. ISDS tribunals, however, tend to use the fair market value of the underlying investment as their reference point independently of the IIA protection standard at stake, including for non-expropriatory breaches (e.g. *CMS v. Argentina*). Such an approach may not be warranted in situations involving, for instance, a procedural obligation (for a case considering this aspect see *Bilcon v. Canada*). In addition, ISDS tribunals tend to adopt a broader understanding than other international courts and tribunals of compensable future profits (box 2).

Box 2
Compensation awards by non-investment dispute settlement bodies

Virtually all international courts and tribunals apply the standard of "full reparation" in the absence of express treaty provisions to the contrary. This includes the International Court of Justice, regional human rights courts such as the African Court on Human and Peoples' Rights (ACtHPR), the ECtHR and the inter-American Court of Human Rights as well as dispute settlement bodies under the UN Convention on the Law of the Sea (UNCLOS).

In line with customary law, courts and tribunals regard material loss to include direct loss and lost future income. With respect to direct loss, the fair market value of lost, damaged or destroyed objects is often equated to the replacement cost. This was done, for example, by the ICJ (see, e.g. *Corfu Channel* case, Judgment of 15 December 1949), UNCLOS Annex VII tribunals (see, e.g. *Arctic Sunrise arbitration*, 10 July 2017) and the ECtHR (see e.g. *Dacia v. Moldova*, 24 February 2009). Where the direct loss could not be quantified because evidence was destroyed or inaccessible, the ICJ has ruled on the basis of equitable principles (see e.g. *Armed Activities on the Territory of the Congo* case, Judgment of 9 February 2022, para 125). The ECtHR and ACtHPR have equally done so when a precise calculation of damages was impossible.

With respect to lost future income, the possibility of making an award for lost profits is generally recognized. However, the above-mentioned courts and tribunals follow the cautious approach of limiting loss of speculative profits. Consequently, a loss of future profits "must be conclusively established and must not be based on mere conjecture or probability." (ECtHR, *Centro Europa 7 SRL and Di Stefano v. Italy*, Judgment of 7 June 2012, para 219). Given the uncertainty related to the loss of a business opportunity, the ECtHR decided that the award of a lump sum on the basis of equitable principles complies with customary international law. Similarly, the ACtHPR recognizes the need for compensation in the case of a loss of a real opportunity. It found that business forecasts may undergo significant changes and equitable considerations should guide the award of a lump sum in such cases (ACtHPR, *Sebastien Germain Ajavon v. Benin*, Judgment (Reparation) of 28 Nov 2019, paras 63-66).

Source: UNCTAD, partially based on IISD, 2022.

ISDS tribunals also differ from the prevailing approach in their use of valuation techniques. In establishing an investment's market value, many ISDS cases encounter the problem that there is often no actual market from which the tribunal may derive the value of the investment. In such circumstances, ISDS tribunals have used different valuation methods to construct the value of the investment. In doing so, ISDS tribunals have privileged income-based valuation methods, such as the discounted cash flow (DCF) analysis (box 3). General international law has been cautious towards income-based methods due to their reliance on projections and, thus, their vulnerability to speculation. The customary rule of "full reparation" only allows for compensation of the injury directly caused by the wrongful act, not speculative, remote, and indirect damage. The ILC Commentary stresses that the DCF method uses "a wide range of inherently speculative elements with significant impact upon the outcome (ILC, 2001b, p 103, para 26)."

As illustrated above, ISDS tribunals tend to differ from the prevailing understanding of the customary law rule of "full reparation" with respect to the scope of injury they consider compensable, their use of valuation techniques, and their characterisation of the inquiry involved. Among others, this difference has raised questions regarding the correctness of ISDS awards. Moreover, concerns relating to consistency across ISDS awards have been voiced as tribunals have in past disputes relied on different assumptions for similarly situated investments. To remedy the perceived shortcomings of past damages awards, without modifying the default customary rule of "full reparation", some recent treaties provide more specific guidance on these issues (see the following section).

Box 3
Valuation techniques in ISDS

There are three main techniques used by ISDS tribunals when assessing damage caused to investors.

Market-based methods aim to determine the value of an investment by inquiring what a willing buyer would pay a willing seller in an arm's length transaction. At times, actual prices or transaction data exist because the investment was recently sold or is a public company with widely traded shares. Often, however, tribunals are required to construct a hypothetical market transaction by trying to compare the investment to the price that was or would have been paid in comparable market situations.

Asset-based methods refer to several different sub-methods. The "book value" method assesses the value of an investment by determining the accounting value of its assets and liabilities. Some tribunals have used a "sunk costs" approach, which considers the expenditure made at the time of creating the investment. Unlike the "book value" method, this does not account for inflation and depreciation. The "replacement method" seeks to determine the cost of replacing an investment with a similar asset.

Income-based methods such as the DCF method aim to determine the present value of expected future income from an investment. The DCF analysis requires, first, to estimate the investment's future revenue minus future costs, meaning its net cash flow. Second, this future cash flow is discounted to today's value. To determine the future cash flows and an appropriate discount rate, tribunals have to make various assumptions as to different types of risks that may affect the investment. Depending on the assumptions used, experts can create extraordinarily different valuations for the same investment.

Source: UNCTAD, based on various sources.

Policy options based on recent IIA practice

The increasingly large damages awarded in ISDS cases and the valuation techniques underlying many awards raise important policy questions. Old-generation IIAs do not sufficiently define the compensation rules for treaty breaches. In the absence of specific treaty provisions, the issue is governed by customary international law. To remedy concerns as to the correctness and consistency of tribunals' interpretation of this standard, including use of the DCF method, States have begun to address a number of relevant questions in their IIAs.

General provisions on remedies, which were rare in old-generation IIAs are present in over 60 per cent of the IIAs with ISDS concluded in the past 5 years (information based on IIA Navigator, for earlier IIA practice see also UNCTAD, 2019). These provisions typically limit the types of remedies available to monetary damages, excluding punitive and moral damages. As a second more recent step, new-generation IIAs are beginning to address some of the problems of ISDS damages valuation practice. Given the growing awareness of the importance of damages and compensation in ISDS proceedings, additional policy options can be adopted to refine existing IIA practice. States, as masters of their treaties, can devise any rule they deem appropriate for the calculation of compensation in their IIAs (box 4).

Box 4
IIA parties can devise tailor-made compensation clauses

Apart from non-derogable *jus cogens* rules of public international law, States can specify and modify rules of international law between themselves through treaties. The "full reparation" standard is one example. The Articles on State Responsibility clarify this point in Article 55 by stating that they serve as residual rules that apply in the absence of special rules.

States may, for instance, specify the conditions that give rise to international responsibility or define the extent and possibility of awarding compensation in greater detail in a treaty. They may implement specifications or modifications through bilateral, regional, or multilateral treaties. Within the investment regime, for example, some recent IIAs differ from their old-generation counterparts and include detailed provisions related to various aspects of the calculations of damages.

Source: UNCTAD, based on various sources.

Balancing compensation rules

Some recent IIAs have departed from past ISDS approaches to compensation. They have done so by providing guidance on a range of relevant circumstances to consider for the assessment of damages. These approaches align with the "full reparation" standard as evidenced by the ILC Articles' express stipulation to take mitigating and contextual factors into account when assessing compensation. In addition to injury, aspects that tribunals should consider include the history of the investor's conduct, the kind of conduct that breached the treaty, the enrichment, if any, of the State, and the public policy considerations behind the measure.

Applicable to expropriation: The most prominent express formulation that balances different factors is the "fair and adequate compensation" standard that applies to expropriation in several IIAs between African countries.[3] Under these treaties, compensation is calculated on the basis of a balance between the public interest and the interest of the affected persons, having regard to all relevant circumstances surrounding the investment's operation. The fair market value of the investment is only one of several factors to be taken into account.

Applicable to all IIA provisions: The Türkiye–United Arab Emirates (UAE) BIT (2023) applies the requirement for an equitable balance between different factors to any award of damages under the BIT, extending the language on expropriation described above to the entire agreement. Under article 13.24:

> 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.

Recent IIAs signed by India with partner countries incorporate similar considerations, including the need to balance the public interest and that of the investor, as mitigating factors in the assessment of compensation.[4] These types of provisions aim to guide ISDS tribunals, while not prescribing or excluding specific valuation techniques.

Other ways to alleviate the burden of large awards in the poorest economies and balance all relevant factors could be to consider a cap on compensation calculated by reference to the amount invested by the investor or the host State's GDP.

The scope of recoverable loss

The ILC Commentary states that injury that is too remote should be excluded from reparation. It further specifies that the requirement of "directness" and "foreseeability" of injury may be used. This is a recognition of the compromise that the general rule of "full reparation" may need to be further clarified to fit a specific area of application. Recent IIAs do so by providing specific guidance on the types of recoverable loss. They typically limit compensation for certain types of future profits or exclude losses that are not directly caused by the IIA breach. Some IIAs offer guidance on the application of the customary standard of "full reparation", while others restate its conditions.

[3] Cabo Verde–Morocco BIT (2023), article 10.3; Central African Republic–Rwanda BIT (2019), article 7.2; Democratic Republic of Congo–Rwanda BIT (2021), article 7.2; ECOWAS Common Investment Code (2019), article 11.6. See also SADC Model BIT (2012), article 6.2, option 1; Pan–African Investment Code (2016), article 12.2; COMESA Common Investment Area Agreement (draft), article 20.3; see also AfCFTA Protocol on Investment (2023).

[4] See India–Kyrgyzstan BIT (2019), article 26.3; Belarus-India BIT (2018), article 26.3; India Model BIT (2015), article 26.3, together with relevant footnotes.

The Türkiye–UAE BIT (2023) offers an example of guidance on future profits and stipulates that compensation cannot include "losses which are not actually incurred nor probable or unreal profits."[5] Other recent drafting approaches specify that "speculative", "hypothetical" or "windfall" profits are not recoverable.[6]

In addition to these emerging practices, States may wish to provide guidance on the applicable reference points for compensation with respect to non–expropriatory breaches. States are free to determine in their IIAs what kind of injury is reparable under different treaty obligations and circumstances, and what the principle of "full reparation" means with respect to different investment protection standards. Compensation for a violation of an investor's due process rights, for example, may not cover the full market value of an investment or award compensation for loss of future profits. Such clarifications would align ISDS practice with the approaches of other international courts and tribunals (box 2).

Causation

A number of recent IIAs seek to clarify causation. Under the India–Kyrgyzstan BIT (2019), for example, the investor must have suffered "actual and non-speculative losses from the breach" that are "foreseeable and directly caused" by it.[7] Other provisions on causation, contributory fault and aggravating conduct restate the conditions under the customary standard of "full reparation".[8]

Additional avenues have been proposed to better align ISDS practice with the causation-related aspects of the customary rule of "full reparation". One approach is to explicitly specify that damages should exclusively provide reparation for the wrongful aspect of the State's measure and not the measure in its entirety (e.g. UNCITRAL, 2023, para 107; IISD Jarrett, 2024).

Valuation techniques

In a nascent trend, recent IIAs are beginning to address questions of valuation. Typically, they point to the relevance of internationally recognized principles of valuation, including equitable principles, and provide information on relevant considerations.

Some treaties express a preference for certain valuation techniques. The choice between different valuation techniques has significant financial consequences. It can be influenced by treaty language. States may detail the conditions under which certain valuation techniques can be applied or indicate preferred valuation methods. The Colombia–Spain BIT (2021), for example, expresses a preference for market-based and asset-based methods for the determination of fair market value. Under article 12.2, valuation should, to the extent possible, be based on "information on recent market transactions on comparable assets and commercial and/or administrative records related to the value of the investment".

5 Türkiye–UAE BIT (2023), Article 13.24.

6 See e.g. AfCFTA Protocol on Investment (2023), article 21.4. See also Indonesia–UAE BIT (2019), article 9.2. Both provisions apply to expropriation. Canada–Ukraine FTA (2023), article 17.36.5(c); Canada Model BIT (2021), article 40.5(c) applicable to the whole IIA.

7 See India–Kyrgyzstan BIT (2019), article 23.2, Belarus–India BIT (2018), article 23.2, India Model BIT (2015), article 23.2.

8 AfCFTA Protocol on Investment (2023), article 21.4; Canada–Ukraine FTA (2023), article 17.36.5(b).

IIAs have also included indicative lists of relevant factors to be considered by tribunals when valuing investments. This includes lists of considerations relevant for asset-based methods of valuation, such as "the capital invested", "depreciation", "capital already repatriated", "replacement value", "asset value including the declared tax value of tangible property".[9] Some IIAs also point to the relevance of "[duration as a] going concern value" or a "record of profitability"[10] of the enterprise. This may guide tribunals away from using income-based methods, such as DCF, for investments that have not been operational for a sufficiently long period of time.

Still, these formulations do not explicitly exclude the use of the DCF method. To provide further predictability, IIAs could prescribe that those losses of projected future income beyond a certain timeframe (e.g. one or three years) are inherently speculative, i.e. non-compensable.

Disincentivizing excessive claims

In addition to the provisions that address compensation directly, there are also complementary IIA clauses that are directed at the practices of some claimants. IIA parties have begun incorporating provisions that aim to disincentivize increasingly large claims. The Colombia–Spain BIT (2021), based on the Colombia Model BIT (2017), adopts a novel approach in this respect. Under article 33.6 of the BIT, any award of damages lower than 50% of the value initially claimed by the investor shall be further reduced by 2% of the difference between the amount claimed and the amount awarded. Other IIAs allow tribunals to apportion costs based on a finding that a claim was frivolous or excessive.[11]

Recent IIA practice shows a growing consensus around the need to provide guidance to tribunals on damages. Options for treaty provisions addressing damages standards range from references to the customary rules on full reparation to lists of specific items of recoverable loss. More detailed policy options have been proposed elsewhere (IISD, 2024).

[9] See e.g. Türkiye–UAE BIT (2023), article 13.24; Indonesia–Switzerland BIT (2022), article 7.4; Hong Kong, SAR China–UAE BIT (2019), article 6.1; Australia–Uruguay BIT (2019), article 7.2; Australia–Hong Kong, SAR China Investment Agreement (2019), article 10.2.

[10] See e.g. Canada–Ukraine FTA (2023), article 17.36.7; Türkiye–UAE BIT (2023), article 13.24; Indonesia–Switzerland BIT (2022), article 7.4; Australia–Hong Kong, SAR China Investment Agreement (2019), article 10.2.

[11] See e.g. Pacific Alliance–Singapore FTA (2022), article 8.32.4

Conclusion

States are increasingly providing clearer guidance on damages and compensation in ISDS proceedings in their new IIAs. Options to do so include relying on balancing factors for compensation; specifying and limiting the scope of recoverable loss; clarifying causation and mitigating factors; providing guidance on valuation techniques; and disincentivizing excessive claims.

Efforts to provide more clarity and guidance to arbitral tribunals for damages and compensation are not occurring in a vacuum. These developments come in the broader context of ongoing IIA and ISDS reform efforts at the bilateral, regional and multilateral levels. These efforts are aligned with UNCTAD's recommendations and have focused on providing more refinements and clarifications to key standards and definitions, strengthening the sustainable development dimension of IIAs; enhancing States' right to regulate; encouraging responsible investments; facilitating sustainable investment; and limiting access to ISDS (UNCTAD, 2020). These developments aim to ensure that IIAs contribute to sustainable development, while minimizing the risk of ISDS cases, especially in case of legitimate measures taken by States to address public policy concerns.

The impact of recent reform efforts is diluted by the slow progress to reform old-generation IIAs. Old-generation IIAs continue to constitute the overwhelming majority of the investment regime and form the basis for virtually all ISDS cases to date. Old-generation IIAs lack the refinements and clarifications needed to protect States from overly broad interpretations by arbitral tribunals. The same holds true for compensation rules, a core question of investor-State dispute settlement, which are not sufficiently defined in treaties. In the absence of specific treaty provisions, compensation rules are governed by customary international law which leaves scope for ISDS tribunals' interpretation. This can result in uncertainty for both States and investors, and potentially disproportionately high damages awards.

UNCTAD has in recent years intensified its efforts to reform the IIA regime and is engaged with national, regional and international partners working on IIA and ISDS reform with the objective of ensuring that the international investment policy regime works for all.

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