Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

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In defense of quantum

by

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In a recent *Perspective*, George Kahale, III bemoaned the so-called "dangerous" state of quantum in the world of investor-state dispute settlement (ISDS) and the alleged tendency of recent ISDS tribunals to award "surreal" amounts of damages that respondent states "could not afford to satisfy even if they were inclined to do so."

Preliminarily, it should be noted that, whether or not respondent states could afford to pay such awards is not an issue arising out of, or caused by, the ISDS system. This suggests that criticism against certain awards may be aimed at giving cover for states to breach their international obligations: first, when violating foreign investors' substantive rights in-country; and second, by refusing to pay when international tribunals order them to do so. It is notable in this respect that the two awards Kahale cites in his piece remain unpaid, as do many other final and unappealable ISDS awards. This is the *actual* "clear and present danger" to the ISDS system.

In any event, there is simply no "crisis" of mega claims. An analysis of ISDS awards shows that states win more often than they lose, and when they lose, investors are typically awarded only a fraction of the damages they seek. A recent report publicized in the *Global Arbitration Review* (analyzing 110 ISDS awards issued from 2017-2020) confirms this: respondent states won 53% of cases (down slightly from 57% in the prior reporting period); and in the 47% of cases that investors won, the median amount awarded was only US$ 39.2 million, representing a mean of just 36% of the amount claimed. Some might argue that this is evidence of "claim inflation," but that is highly simplistic: damages are often reduced not because the claimant's quantum case itself was "inflated" but rather because the tribunal reaches a different liability determination. Moreover, while some may scoff that even these reduced amounts still present significant financial burdens for states, such awards are generally intended to compensate for value and benefits that the state has already taken for itself.

Even assuming there were a crisis of mega claims, the following two consideration should be borne in mind. First, it is not correct that there are few rules to curb claim exaggeration. Claimants have to present credible quantum claims, and there are significant risks, both in terms of overall case credibility and cost-shifting, in not doing so. Second, there is no proliferation of professional experts giving exaggerated claims a veneer of credibility, nor are counsel and arbitrators ill-equipped to counter their assessments. Since time immemorial, the primary aim of dispute resolution is to determine compensation to the injured party. ISDS is no different—it is just that ISDS disputes often involve investments worth hundreds of millions (or billions) of dollars for long-term infrastructure or extractive projects. It is the duty of all ISDS participants to give quantum issues the careful attention they deserve, and it is the role of clients to select counsels (and counsels to select arbitrators and experts) who are best suited to this critical task. Where they fail to do so, they should bear the blame, not the ISDS system. Indeed, ISDS cases are bespoke, consensual international arbitrations—there is no real "system" to blame beyond the individual participants in any given case. Thus, while quantum issues could often benefit from additional hearing time—or even a separate hearing—the burden is on the participants to make this happen.

The use by some tribunals of discounted cash flow (DCF) to value non-producing projects should not be demonized. Almost all ISDS instruments require compensation to be based on "fair market value" or similar, and it is not seriously disputed that real market participants invariably use DCF as the primary tool of valuation, irrespective of the actual life phase of an investment. Despite this, a significant majority of ISDS tribunals rejects the use of DCF for early-stage projects, citing precisely the reasons Kahale advances. A limited exception has so far arisen in extractive industries, where ready and transparent market data exist on the key drivers of valuation. Indeed, cases like *P&ID v. Nigeria* and *Tethyan v. Pakistan* involved natural resources (gas and copper, respectively). While one may criticize the discount rates the tribunals used in conducting the DCF analysis to assess quantum, it would be misleading to conclude that those tribunals did not address the issue with due care. In fact, both tribunals provided detailed reasoning on the selection of the discount rate: disagreement does not a crisis make.

To conclude, there is no quantum "crisis". But that is not to say that current practices are perfect. Parties and tribunals should devote more time and attention to quantum issues, particularly where liability is clear or even stipulated (e.g., nationalization cases). This could take the form of a separate quantum hearing, perhaps with the benefit of a tribunal-appointed quantum expert. Tribunals can and should engage more fully with real-market-valuations of assets. And states must be held to account at the enforcement stage, lest quantum awards—"mega" or otherwise—be worth less than the paper on which they are written.

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