



BALTIC ARBITRATION DAYS

PANEL II: SETTING ASIDE PROCEDURES INVOLVING A STATE-OWNED ENTITY PARTY

COULD THE HOLY GRAIL BE A MIRAGE?: *WHEN STATES TRY TO SET ASIDE AWARDS ON DAMAGES RELATED ISSUES...AND WHEN THEY SUCCEED*

*Presented by
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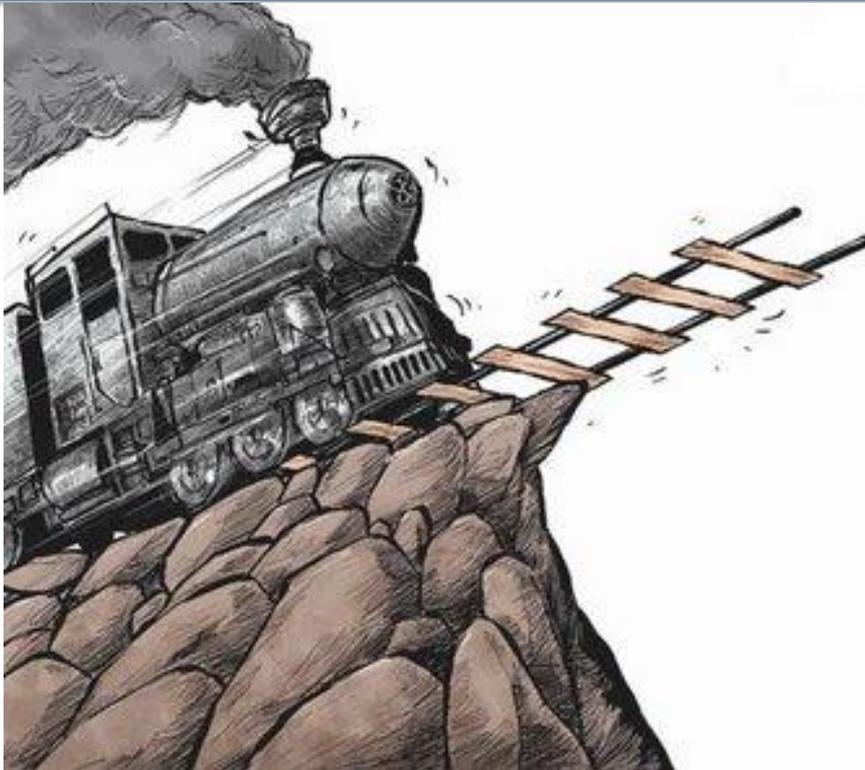
WHEN MIGHT WHAT'S DONE...**NOT** BE DONE?



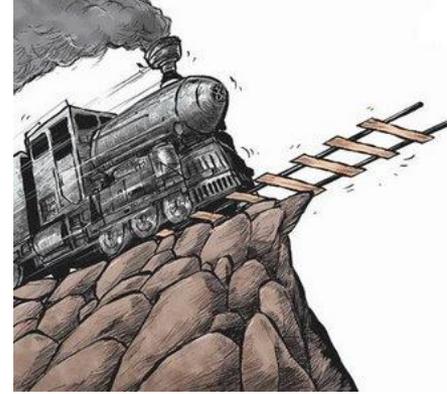
WHEN MIGHT WHAT'S DONE NOT BE DONE? ANNULMENT REQUESTS BASED ON DAMAGES

- I. Yukos v. Russian Federation
- II. TESCO v. Guatemala
- III. Burlington Resources vs. Republic of Ecuador
- IV. Some Potential Implications for Tribunals and Damages

THE RUNAWAY TRIBUNAL: YUKOS V. RUSSIAN FEDERATION



THE RUN AWAY TRIBUNAL: YUKOS V. THE RUSSIAN FEDERATION



Background:

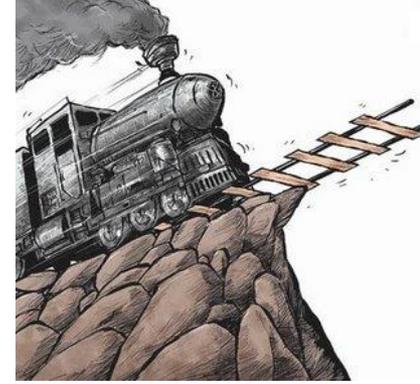
The dispute between Yukos and Russia started with Moscow's pursuit of Yukos and its chief executive, Mikhail Khodorkovsky for alleged tax evasion.

Following the dissolution of Yukos by Russian authorities in 2003 and the arrest of Mikhail Khodorkovsky, Yukos's majority shareholders – Hulley Enterprises, Yukos Universal and Veteran Petroleum – commenced arbitration against Russia.

The claimants alleged that Russia had breached its obligations under the ECT through a series of actions which eventually saw the transfer of Yukos's assets to state-owned energy giants, Rosneft and Gazprom.

The Russian Federation alleged that the claims in fact involved a domestic Russian tax dispute concerning *Russian* tax assessments against a *Russian* company that was owned and controlled by *Russian* nationals.

THE RUN AWAY TRIBUNAL: YUKOS V. THE RUSSIAN FEDERATION



Award:

Tribunal Award: US \$50 Billion

“US \$114 Billion”



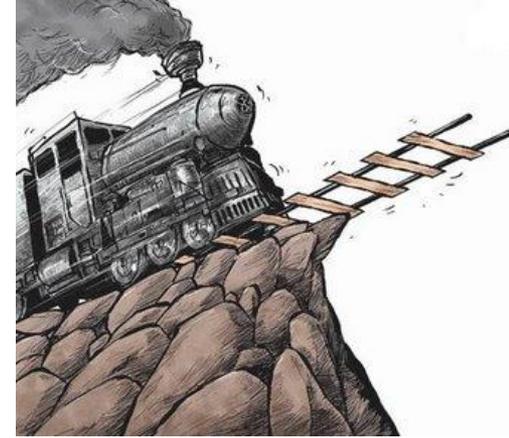
Claimants' Expert

“No Comment”



Respondent's Expert

THE RUN AWAY TRIBUNAL: YUKOS V. THE RUSSIAN FEDERATION



Annulment: In a judgment issued on April 20, 2016, the District Court of The Hague in the Netherlands ruled that that the Tribunal lacked jurisdiction over the claimants' claims because the Russian Federation never ratified the ECT, and agreed (in accordance with Article 45(1) ECT) to apply it on a provisional basis only *"to the extent that such provisional application is not inconsistent with its Constitution, laws or regulations."*

Because of the above ruling which annulled the award, the Dutch court did not address other arguments brought by the Claimant including:

"...that the tribunal's damages award was based on the its own deeply flawed methodology, which had not been advocated by any of the parties and resulted in substantial double counting of the claimants' purported losses."

SHOCK AND DISBELIEF: TESCO V. GUATEMALA





Background:

- Claimant, TESCO (TESCO Guatemala Holdings), in this case brought its claim under Article 10.5 of the DR-CAFTA..
- The dispute arose related to TESCO's investment in the Guatemalan electricity distribution company, EEGSA. It centered around what was characterized as Guatemala's "arbitrary and unjustified" decision to decrease EEGSA's electricity tariffs for the 2008-2013 tariff period by unilaterally reducing the Value Added for Distribution ("VAD") component of those tariffs, as well as the actions that Guatemala took to achieve that objective. The VAD is the primary component of the tariff through which the distributor recoups its investment and makes its profit.
- In arbitration, the Claimant's sought compensation for historical lost profits and diminution in value of their interest in EEGSA due to the distressed sale at a significant discount due to the actions of the Guatemalan Government.



The Award:

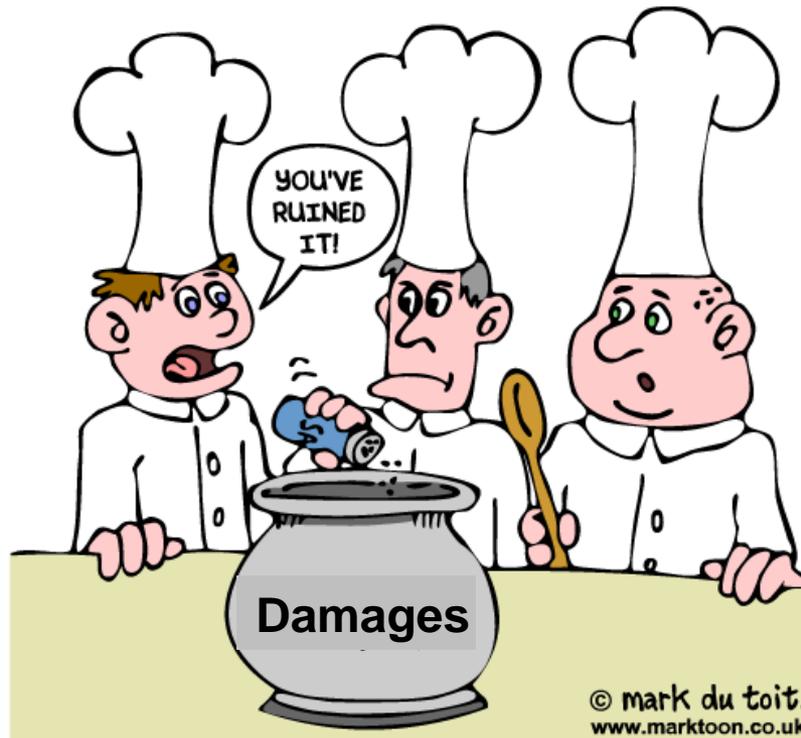
- The Tribunal awarded 100% of historical damages in an apparent acknowledgement of the wrongful actions of the Guatemalan government.
- The Tribunal awarded 75% costs of the arbitration to the Claimant to be paid by the Respondent.
- The Tribunal did not award anything for the diminution in value due to the distressed sales price.
 - The tribunal's reasoning was that the Claimants had not introduced any evidence that the purchaser would have paid more for the asset in the actual scenario when the sale took place absent the government actions (i.e. the application of lower electricity tariffs).



The Annulment:

- In reviewing Claimant's assertion that the Tribunal's Failure to state reasons for not awarding damages: the Commission found that the Tribunal's reasoning for denying TESCO damages for loss of value could be reconciled with its other findings and that there was no inconsistency in awarding past damages but not future damages. So the annulment was not made on this basis.
- On Claimant's assertion of the Tribunal's Failure to state reasons and that the Tribunal disregarded the extensive documentary and expert evidence on loss of value, the Committee considered that the Award's decision on the loss of value claim did not meet the standards set out by Article 52(1)(e) of the ICSID Convention and needed to be annulled on this ground.
 - In TESCO's words,
"[O]ne cannot 'follow how the tribunal proceeded from Point A. to Point B. and eventually to its conclusion' with respect to its decision not to award TESCO any damages for its loss upon the sale of its shares in EEGSA."

TOO MANY COOKS SPOIL THE DAMAGES?: BURLINGTON RESOURCES V. ECUADOR



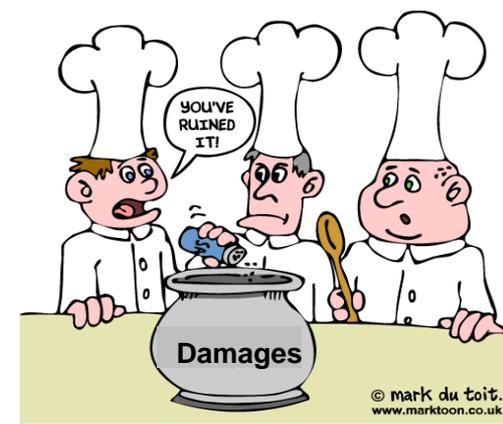
TOO MANY COOKS SPOIL THE DAMAGES?: BURLINGTON RESOURCES V. ECUADOR BACKGROUND & AWARD



Case Background:

- 2000: Burlington started to acquire ownership interests in Production Sharing Contracts for the exploration and exploitation of oil reserves in Ecuador.
- The dispute between the Parties arises out of the following two issues:
 - 1) Ecuador's purported failure to protect Burlington's exploration and exploitation activities in Blocks 23 and 24 from local indigenous opposition, and
 - 2) Ecuador's enactment of measures which, purportedly in breach of its contractual and Treaty obligations, unilaterally increased its participation under the PSCs on so-called "unforeseen surpluses."
- Law 42 (19 April 2006): imposed a participation of 50% over so-called "non agreed or unforeseen surpluses from oil selling prices" on private contractors having PSCs in force with Ecuador.
- Decree No. 662 (18 October 2007: together with Law 42 which increased Ecuador's additional participation for "non-agreed or unforeseen surpluses" from 50 percent to 99 percent.
- On 3 March 2009, an Ecuadorian Executory Tribunal ordered the seizure of Block 7
- and 21 oil crude production.

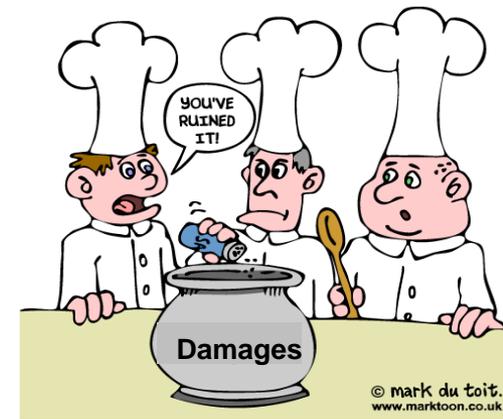
TOO MANY COOKS SPOIL THE DAMAGES: BURLINGTON RESOURCES V. ECUADOR ANNULMENT DAMAGES ISSUES



The Award:

- At the Tribunal's request (as discussed and agreed with the Parties and their experts prior to the close of the Hearing), the Parties' experts submitted a joint valuation model allowing for the calculation of potential damages according to the DCF methodology under different assumptions and scenarios in the joint "Model".
- The Tribunal stated that, to the extent that each Party's assumptions are applied as described in each expert's individual report, the result of the joint model replaced the experts' previous damages figures. This was particularly relevant for valuations using the date of the award or valuations of interest, which vary with time.
- On 27 July 2016, the Tribunal asked the experts to update the Model, providing additional assumptions and specifications in an "Updated Model". The experts did so on 20 September 2016 and the Parties commented on the Updated Model on 4 October 2016.
- Using the Updated Model provided, the Tribunal gave an Award on February 7, 2017 quantifying Burlington's lost profits at **USD 379,802,267**.

TOO MANY COOKS SPOIL THE DAMAGES: BURLINGTON RESOURCES V. ECUADOR ANNULMENT DAMAGES ISSUES



The Request for Annulment:

Claimants assert:

- The Tribunal applied customary international law compensation of “full reparations” instead of the Treaty standard of compensation when determining the damage, thereby failing to the applicable law to the dispute.
- The Tribunal further erred in its application of customary international law.
- The Tribunal manifestly exceeded its powers and failed to state its reasons when it ignored the economic effect of Law 42 in its damages calculation. the Tribunal failed to state the reasons upon which its decisions were based.
- The Tribunal held that it was “*satisfied that using the current functionalities contained in the Updated Model allow[ed] it to quantify Burlington’s losses with reasonable certainty.*” In doing so, the Tribunal failed to state the reasons on which it based its adjustment of the Updated Model to reflect the deferral of the drilling start date.
 - The Updated Model had inherent limitations which have led to an improper calculation
 - The Tribunal has failed to state the reasons for the subtraction of only USD 3,238,801 to account for the 1.5 year deferral of the drilling start date

WHAT HAVE WE LEARNED: IMPLICATIONS FOR PARTIES TRIBUNALS AND TRIBUNALS FROM THESE CASES



MY FINAL SAGE WORDS OF ADVICE:



- Think once, twice, three times about the instructions you are giving to your expert:
 - Ultimately, overly aggressive and unreasonable assumptions can be harmful if not fatal to your case.
 - Note: You can only truly know if the major assumptions are unreasonable if you understand the damages claim.
- If they don't agree with either expert's approach, Tribunals should seriously consider using the party-appointed experts from both the Claimant and Respondent to help them craft/adjust their damages figures based on their particular set of assumptions or several sets of assumptions.