

Expert Testimony in Investor-State Disputes

Steve Saeger and **Mark Berberian** — 7 MIN READ

Expert witness testimony on the merits can be key to helping arbitral tribunals decide whether foreign investors received "fair and equitable" treatment from host governments.

Applying the Standard

In international arbitration, arbitral tribunals typically rule on a variety of issues, including the merits of the claimant's allegations and the quantum of damages or harm that the claimant has allegedly suffered. While experts commonly opine on the calculation of damages, their testimony can also be helpful in assessing the merits of a case (i.e., liability). Depending on the type of international arbitration (e.g., investor-state or commercial), the merits phase can encompass a number of different questions.

For investor-state disputes, this phase often focuses on whether investors received fair and equitable treatment from the host country – a criterion often called the "FET standard." While the legal interpretation of the FET standard may vary, arbitral tribunals generally have defined the FET standard as encompassing several different elements. For example, one tribunal explained the standard as "an obligation to act transparently and with due process; and to refrain from taking arbitrary or discriminatory measures, or from frustrating the investor's reasonable expectations with respect to the legal framework adversely affecting its investment."[1]

The nature of the allegations of FET breaches varies greatly.

At a high level, claimants often maintain one or more of the following:

- The host government provided assurances that the challenged policy would not be implemented.
- A regulatory change could not have been reasonably foreseen at the time of investment.
- The policy change unfairly targeted foreign investors or was arbitrary and/or discriminatory.

While respondents will assert a variety of *legal* defenses to respond to such claims, they typically will also try to respond to *substantive* and *factual* claims.

Depending on the circumstances, typical responses that governments facing these types of claims may make include:

- The policy change at issue was necessary to address changing circumstances, whether driven by broad economic trends such as a financial crisis or firm-specific regulatory issues.
- Investors should not reasonably expect a government to sacrifice the environmental, health, and safety concerns of its citizens to meet broad, non-contractual commitments.
- The policy change was not discriminatory because it was applied equally to foreign investors (including the claimant) and domestic investors.
- The risk of a change in policy was well understood in the market when the investment was made and the policy risks were priced (and, in some cases, disclosed in the offering documents).
- The policy change did not result in the alleged harm – that is, there is no causal link between the alleged FET breach and damage to the claimant. For example, if the claimant was already in financial distress prior to a change in policy, then the value of the claimant's investment may not have been adversely impacted, even if the allegations are found to be true.

Into the (Alleged) Breach: A Potential Role for Experts

Tribunals are thus faced with the task of having to evaluate these opposing positions in order to assess whether an actual FET breach occurred. Fact witnesses can provide important evidence explaining the parties' perspectives as to why certain policies were or were not implemented, or on the nature of an investor's expectations prior to making an investment. However, it can be challenging for tribunals to evaluate these competing positions given the perceived or actual biases of fact witnesses, particularly when the documentary record is limited or the passage of time has clouded memories.

In such situations, expert witness testimony on the merits of the parties' claims of FET breaches can be particularly valuable in assisting tribunals. The types of analysis and the nature of expertise that will be most informative to tribunals will, of course, vary from case to case. At its core, however, expert testimony can assist tribunals in evaluating the reasonableness of the parties' actions by placing them in a broader context, whether that means the changing circumstances to which government or regulatory policies have responded, investor expectations at the time an investment was made, or the nature of due diligence conducted prior to an investment.

Assessing Alleged FET Breaches: Expert Testimony in Banking Arbitrations

To illustrate how expert testimony can potentially be used in addressing allegations of FET breaches, it is helpful to discuss arbitrations that have included these submissions. For example, Analysis Group has supported experts in a number of investor-state arbitrations related to a government's supervisory response to failed or troubled financial institutions. Key issues in these matters have focused, in part, on allegations that bank supervisors – officials tasked with overseeing compliance with a nation's banking regulations – acted in an arbitrary or discriminatory manner, harming the interests of investors or uninsured depositors.

These banking arbitrations illustrate several ways in which expert testimony can assist tribunals.

First, an expert can provide background on the evolution of practices at the international level, through reference to typical supervisory practices in other countries as well as by examining the recommendations of supranational entities such as the Financial Stability Board or International Monetary Fund. This kind of testimony can be invaluable in providing a tribunal with the broader context in which supervisory actions are taken, as well as a benchmark against which the reasonableness of the supervisor's actions can be assessed.

This context can be particularly important when assessing shifts in the supervisory frameworks of countries over time. For example, following the global financial crisis of 2008, the fallout from widespread bailouts of troubled institutions led to global efforts to reform the framework for handling banking crises. These reforms not only drove significant changes in the supervisory approach in many countries but also required investors to reassess expectations about how bank supervisors could be expected to act.

One issue addressed in the investor-state arbitration between Marfin Investment Group (MIG) and others and the Republic of Cyprus provides a concrete example of how expert testimony of this type can assist a tribunal. Marfin Popular Bank, which was controlled by MIG, sustained large losses on its holdings of Greek government bonds during the Greek government debt crisis, which adversely impacted the bank's financial condition. MIG claimed in the arbitration that Cypriot authorities breached their obligations under a bilateral investment treaty by failing to negotiate an exemption for Cypriot banks – including Marfin Popular Bank – from private sector involvement (PSI) in the restructuring of Greek government debt in 2011.[2]

In support of its decision in favor of Cyprus, the tribunal quoted extensively from a joint expert report of Professor Jean-Pierre Landau of Sciences Po and Professor Andrew Metrick of the Yale School of Management. The report discussed the Eurozone's handling of the Greek debt crisis and the reasonableness of the Cypriot policy response. The tribunal noted that it found these quoted passages from the expert report to be "particularly enlightening… [in] describing the events surrounding the Eurozone summit"[3] and determined that there was "nothing arbitrary, capricious or unreasonable in Cyprus' lack of attempt to negotiate for itself an exemption or a mitigation of the PSI+ program."[4]

Second, an expert can also assist tribunals in understanding more conceptual or complex industry-specific issues. For example, the concept of "solvency" can have different meanings when considered from a bank supervisory perspective as compared to an accounting perspective. From the latter, a bank may be considered "solvent" if its assets exceed its liabilities (i.e., it has positive capital). But bank supervisors are focused on a more dynamic view of solvency that is intended to ensure that a bank has sufficient capital to absorb unexpected losses and protect depositors.

This difference can be of critical importance for bank supervisors in determining the appropriate supervisory response to a financial institution's situation. While fact witness testimony and documents can help establish an evidentiary record, it may also be necessary for experts to engage in a detailed analysis of an institution's financial condition and the supervisory response to understand the context in which a supervisor acted and the reasonableness of those actions.

Finally, expert testimony can aid the assessment of whether a government policy was discriminatory toward foreign investors. This type of analysis must go beyond a simple assessment of whether foreign investors were more deeply affected by a policy change than domestic investors were, since this kind of discrepancy is not by itself evidence of a discriminatory policy. A number of factors unrelated to the nationality of the owners can drive changes in the policy or regulatory stance of the government. Differences in the business strategies of foreign-owned banking institutions relative to domestic competitors can result in differing risk exposures. This, in turn, can necessitate a differential supervisory stance for foreign and domestic institutions in response to differing levels or types of risks, rather than in response to the nationality of the bank.

Experts have many tools available to analyze allegations related to FET claims. In addition to analyzing the supervisory frameworks, econometric analysis can also be helpful in many cases in assessing whether or not a policy has a discriminatory effect. Experts can utilize econometric models and other types of data analysis to disentangle these effects.

A Bespoke Approach

The nature of the analysis that will be of most value to tribunals in investor-state disputes (or more broadly) will vary greatly depending on the issues at stake. As such, a "one-size-fits-all" approach will generally not be effective in addressing the merits of each case; experts should be carefully chosen based on their particular expertise and its relevance. This type of specialized expert testimony can help tribunals fill in the gaps in their understanding and thus better allow them to assess the merits of alleged breaches. ■

Endnotes

1. *Electrabel S.A. v. Hungary*, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, International Centre for Settlement of Investment Disputes (ICSID) Case No. ARB/07/19, ¶7.74.
2. *Marfin Investment Group Holdings S.A., Alexandros Bakatselos and others v. Republic of Cyprus*, Redacted Award, 26 July 2018, ICSID Case No. ARB/13/27 ("Marfin Award").
3. Marfin Award, ¶872.
4. Marfin Award, ¶874.