Inadequate Handling of Damages in International Arbitration

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The portion of the award that causes considerable consternation for parties and tribunals is often the section dealing with damages. Tribunals do not always award all or even the bulk of the damages claimed and this increases the dissatisfaction for users of arbitration services, dissatisfaction brought about by unexpected outcomes in arbitration claims. As parties become more sophisticated and hire the relevant legal and financial experts who have the time and resources to dedicate to the case, it is inevitable that complexity is inherent in damages claims and this needs to be competently addressed to ensure arbitration remains relevant. Large awards of damages, in and of themselves, don't undermine the system. It is the lack of analysis or improper analysis that does.

This article takes a closer look at three of the drivers that could lead arbitration practitioners to inadequately handle quantification of loss and damages claims in international arbitration: the differences in approach, practitioners not stepping up, and damages experts.

Differences in approach

The first of the three drivers listed above is the differences in approach, especially where developing arbitration jurisdictions are involved.

Assumptions are often made as to a baseline or uniformity when it comes to interpreting or applying what may seem to be trite concepts,

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legal provisions or 'common' practice, but that is not always the case. In quantifying damages, the role of experts is often central. Yet this aspect of the handling of damages varies across jurisdictions more than is often realised. In some jurisdictions, the role of experts may not be as clearly established or established differently from that in other jurisdictions.

In 2019, the People's Court of Hanoi set aside an arbitral award that had been issued under the Vietnamese Law on Commercial Arbitration 2010 (VLCA) because the tribunal did not use its own expert but relied on the evidence of one of the parties' experts.[1]

In this case, the dispute arose out of a contract for the construction of a hydropower plant project. The contractors terminated the contract against the employer and commenced arbitration under the Arbitration Rules of the Vietnam International Arbitration Centre against the employer to claim amounts due and owing. The tribunal issued an award unanimously in favour of the contractors.

The employer applied to the People's Court of Hanoi to set aside the award on a few grounds, one of which was the tribunal's sole reliance on the contractors' expert report (instead of engaging in its own assessment of the quantum of damages). The People's Court of Hanoi held that the tribunal's decision to rely solely on the contractors' quantum expert report was in breach of Article 46.3 of the Vietnamese Law on Commercial Arbitration, which states that '[t]he arbitral tribunal, on its own or at the request of one of the parties, *has the right to procure expert assessment* and valuation of property in the dispute as a basis for the settlement of the dispute' (emphasis added).

The Court's view appeared to be that the tribunal's power under Article 46.3 to 'procure expert assessment' is a *mandatory* obligation.

While this does not seem to square with the language of the statute, tribunals in Vietnamese-seated arbitrations should consider whether they may have to appoint their own expert instead of relying only on expert evidence from party-appointed experts.

In Indonesia, while expert determination is permissible under Indonesian arbitration law, it is not that frequently used in practice. Parties may make a commercial agreement to seek a binding opinion by an expert, but there is a risk of a party challenging binding expert opinions in the courts. Further, the law is unclear when it comes to objections and challenges relating to expert evidence.

Apart from how experts are used, cultural nuances between jurisdictions result in the adoption adoption of approaches that may not be so widely used by

1 Vietnam – Decision 11/2019/QD-PTT on 14 November 2019.

tribunals in other jurisdictions. This is despite the genesis for such approaches lying in the same or similarly worded arbitration legislation or rules.

In India, the courts have firmly endorsed the 'honest guesswork' principle in arbitrations. This principle recognises the power of the arbitral tribunal to make an honest 'guestimate' and there have been several cases upholding awards where the tribunals have made an estimated guess when quantifying the damages for loss of profit.

In 2010, the Delhi High Court[2] identified the source of this power as being the generally worded provision in the Indian Arbitration Act empowering arbitral tribunals 'to determine the admissibility, relevance, *materiality and weight* of any evidence'[3] (emphasis added).

The Delhi High Court also highlighted that because the arbitral tribunal is not bound by the strict principles of the Indian Code of Civil Procedure and the Indian Evidence Act, the use of honest guesswork by arbitral tribunals is justified. Indeed, guesswork and estimation by the tribunal was seen as falling within the purview of the tribunal's appreciation of evidence:

> 'before this Court interferes with an Award, it is necessary that the Award is illegal or violative of the contractual provisions or perverse. I do not find any perversity or illegality whatsoever in the approach of the Arbitrators who have after examining in detail the entire record made an honest guesstimate, which the Arbitrators were entitled to do.'[4]

There are, however, a few points to note when it comes to relying on this principle in construction cases.

The seminal case dates back to 1984, *A T Brij Paul Singh v State of Gujarat,*[5] where the Indian Supreme Court held that every contract for civil works will be made with the expectation of profit. Hence, a claim for loss of profit is de rigueur where the claim is for breach of civil works contracts. The loss of profits can be 'guestimated' and while carrying out that exercise, it would be unnecessary to go into the minutest of details.

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2 *National Highways Authority of India v ITD Cementation India Ltd* (2010) Case No OMP 23/2007.

3 'Section 19 of the Arbitration and Conciliation Act 1996: Determination of rules of procedure –
(1) The arbitral tribunal shall not be bound by the Code of Civil Procedure, 1908 (5 of 1908) or the Indian Evidence Act, 1872 (1 of 1872).
(2) Subject to this Part, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting its proceedings.
(3) Failing any agreement referred to in sub-section (2), the arbitral tribunal may, subject to this Part, conduct the proceedings in the manner it considers appropriate.
(4) The power of the arbitral tribunal under sub-section (3) includes the power to determine the admissibility, relevance, materiality and weight of any evidence.'

4 *National Highways Authority of India v ITD Cementation India Ltd* (2010) Case No OMP 23/2007.

5 AIR 1984 SC 1703.

In *A K Sinha* v *Mahanagar Telephone Nigam Ltd And Ors* [2009],[6] an award was challenged because the tribunal had not awarded loss of profits for breach of the contract, and the applicant argued, following *A T Brij Paul*, that it was not necessary to *prove* loss of profit for the granting of damages, since once the breach is proved the tribunal can undertake honest guesswork to determine the quantum of damages to be awarded. The Delhi High Court affirmed that 'honest guesswork' can be undertaken to calculate the damages (for loss of profit), but the parties would have to lead the evidence before such an assessment could be made.

Almost a decade later in 2017, the Delhi High Court set aside an award where the tribunal relied on the 'honest guesswork' principle to create its own formula (called 'notional proportionate loss' to quantify damages).[7] Although the contract between the parties specified that the responsibility and costs of the machinery was entirely on the contractor/SMS Ltd, the tribunal's formula involved a sharing of these costs. Accordingly, the Delhi High Court found that the manner in which the tribunal carried out the quantification was perverse and contrary to the evidence before it. The Court also criticised assumptions the tribunal had made as to the period of time for which the loss was sustained, finding such assumptions to be unreasonable and inconsistent with the evidence which included the role played by the employer in delaying the removal of machinery from the site.

Therefore, 'honest guesswork' has a limit. The use of ill-conceived formulae with no precedential backing or an industry standard level of acceptance is unlikely to be accepted as the basis for quantifying the loss. This is especially so if the application of the formula would be inconsistent with the evidence before the tribunal.

For completeness, the use of honest guesswork by tribunals in areas other than for loss of profits is possible, as long as the breach has been established and appropriate evidence has been put forth to help in quantifying the loss caused.

This was the case in *Bata India Limited v Sagar Roy*,[8] where the arbitrator dealt with claims for non-payment arising from renovation work that had been carried out. The tribunal accepted evidence that the claimant had used material which was cheaper and inferior to the quality mentioned in the contract and employed honest guesswork to reduce the claimed amount by 15 per cent, since the exact quantity and price of the cheaper material used was not available. This was upheld by the Calcutta High Court which asserted that it could not sit in appeal over the honest guesswork made by the tribunal.

6 OMP No 457 of 2008.

7 *SMS Ltd v Konkan Railway Corporation* [2017] OMP 279 of 2017.

8 AP No 5 of 2013; judgment of the Calcutta High Court dated 29 October 2014.

In short, while the trend in Asia is one that is generally and increasingly pro-arbitration, there may still be practical challenges arising from the different nuances and approaches developed in law and practice.

Practitioners not 'stepping up'

Finally, arbitration practitioners not 'stepping up' to sufficiently master and engage meaningfully with the quantum exercise is another key driver for the inadequate handling of damages in international arbitration.

Being financially numerate and having a more than superficial understanding of valuation methodologies is central to the practice of other areas of law, such as mergers and acquisitions, capital markets, finance, restructuring and tax practices. Lawyers regularly display a good grasp of such knowledge when advising on capital reduction exercises and financial assistance, among others.

Corporate lawyers need to understand the financial valuation thesis in order to advise and prepare transaction documents that effect appropriate accounting and valuation adjustments. Without this knowledge, they would not be able to ensure the right mechanism goes into the documents: adjustment mechanisms, financial covenants and warranties and indemnities. Restructuring lawyers routinely deal with a distressed company's finances and understand basic financial and accounting concepts (including cash flow, debt and leverage ratios and liquidation analysis) in order to be able to assess where the distressed company is (and where it needs to be) and explain this to a court and stakeholders with varying levels of financial literacy.

Yet in such corporate practices there isn't the same level of delegation of the 'mental burden' to experts (as there is in international arbitrations) when it comes to the valuation aspect of these transactions. International arbitration practitioners undergoing training in valuation models and methodology can help demystify this aspect of the job and become more confident and capable of taking real ownership of quantum issues.

Damages experts

Third, damages experts themselves can and do contribute to damages being handled less than satisfactorily.

The quantum exercise is sometimes unnecessarily complicated when experts perform as a 'hired gun' or disagree for the sake of disagreeing. The latter is sometimes out of a (mistaken or otherwise) assumption – given the adversarial setting – that agreeing on any aspect of the other side's expert

report is not doing the job properly. There is also the challenge of financial experts going off on their own tangent, resulting in expert evidence often going beyond what the parties contemplated during the negotiations. None of this assists the parties or the tribunal and increases the time and cost of the exercise, as well as the complexity.

To be fair, damages experts sometimes go off tangent or provide divergent opinions because they are relying on fundamentally different legal/factual assumptions (as per their instructions) and this places the real fault back at the practitioners' door. While there are procedural developments that are intended to address this issue (eg, hot-tubbing, Scott Schedules, the Kaplan Opening, joint expert reports, party-appointed experts meeting independently to narrow the disconnect, etc), if arbitration practitioners 'level up' to close the language and knowledge gap between themselves and quantum experts, the instructions to the expert can be better framed and more on point right from the outset. Financial accounting should not be translated or viewed solely through a legal language framework if there is to be more meaningful collaboration between experts and practitioners.