Q&A with Dr. Manuel A. Abdala

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Dr. Manuel A. Abdala is a Ph.D. in economics from Boston University and an Executive Vice President with Compass Lexecon. He has provided written and oral expert testimony in more than 130 international arbitration cases, many of them involving treaty disputes between private investors and governments on topics related to damage valuation, as well as opinions on government conduct vis-a-vis investors' expectations and regulatory standards. He also has substantial experience in commercial arbitrations in shareholder disputes, competition clauses, property damages, and political risk insurance claims. He has published extensively on topics covering infrastructure economic regulation, institutional design, utility privatization and valuation, industry structure, and competition policy. Dr. Abdala has completed projects on ex-post privatization analysis in several countries, including various research studies led by the World Bank. He has conducted numerous works and studies for private companies and public institutions related to business valuation, damage analysis, and regulatory analysis of infrastructure projects in multiple countries in the Americas, Europe, Asia, and Africa.

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Q. Dr. Abdala, you are described in WWL's survey as a "legend in the field" by peers, and you are being praised for your skills and ability to present testimony in a clear and persuasive manner. How did you get involved as economic expert in arbitration cases in the first place?

A: As an economist, I had advised governments and institutions on several occasions on how to privatize or regulate industries in infrastructure sectors. In the late 1990's I was asked to testify as regulatory expert in a matter that dealt with a tariff review in electricity distribution. The case was settled early on and so I didn't get the chance to provide oral testimony, but soon thereafter I got involved as regulatory expert in two water cases against Argentina: the *Azurix* matter where I was fortunate enough to work with some great professionals, including Doak Bishop and Guido Tawil as counsel; and the *Suez et al* (Aguas Argentinas) case where I worked alongside Nigel Blackaby and many of his colleagues. These lawyers were terrific, and really showed me the importance of economic testimony that is independent, persuasive and trustworthy. In return, I like to think that I conveyed to them the importance of the economic regulatory opinion, which is intrinsically linked to a solid construction of *but-for* scenarios, and which, in turn, directly affects the quantum of damages.

Q. I understand that despite your roots as being a regulatory expert, you soon became involved as a quantum of damages expert in several cases. What is the link between being an economic regulatory expert and a quantum expert?

A: Most treaty investment disputes relate, in one way or another, to a regulatory dispute. There are plenty of these cases in which, for example, governments increase the applicable taxation or royalties, reduce subsidies, apply arbitrary decisions in tariff reviews, suspend price indexations, freeze tariffs altogether for political motivations, or introduce tougher environmental or investment requirements. All of these actions typically require an assessment of *proper* regulatory conduct, as arbitrators in these disputes are often tasked with determining government's conduct in the absence of the alleged breach. This is where economists with a proper training and practice in regulatory economics can step in to illustrate how governments and regulators alike could change regulation so as to adapt to changing circumstances, or to adopt new public policy objectives, but following regulatory procedures that are seen as standard practices in countries with solid institutional frameworks, without discriminating against investors or acting arbitrarily. In this context, it is easy to see the relevance of a solid regulatory opinion when quantifying damages: damages are anchored to the value of the affected assets under a *but-for* scenario that must be built under the assumption that regulatory conduct would have been proper.

Q. And how do you translate such expert opinions of "proper regulatory conduct" into quantum considerations?

A: To start, "proper conduct" is a concept that's open to interpretation; in other words, there's a margin for discretion, both from a legal and economic perspective. It follows, then, that an economic expert's construction and justification of such but-for conduct, based on comparable evidence of economic regulation as recommended by best practices, is critical to developing a robust quantum case. Often times, observing similar regulatory conduct provides the best interpretation, so long as such conduct is from the same agency at a different period in time, or relates to regulation of other companies in the same or comparable industries. For example, in the *EDFI v. Argentina* case, there was a significant dispute concerning the construction of a counterfactual tariff review. The regulator could have used as the asset base either (i) the actual bid price at the time of the privatization, (ii) the second best bid, or (iii) the official reference price, which was less than half the actual bid value.

By relying on economic evidence of prior regulatory conduct from Argentine electricity and natural gas regulators in earlier periods, the Tribunal rightly concluded that allowing the actual bid price as the initial asset base would constitute proper "but-for" regulatory conduct.

Q. Do you think Tribunal's rulings on regulatory matters or on how expropriation cases are decided on issues of quantum have any impact on current foreign investment decisions?

A: Yes, I do think that they certainly have an impact. In a general sense, Tribunal's rulings on these matters provide comfort to investors in knowing that arbitrators are willing to put themselves in the 'shoes of a fair regulator' to eventually provide compensation for a regulatory decision that was deemed unfair and resulted in economic harm. As it relates to expropriation cases specifically, good decisions on quantum provide substantive evidence of the remedies to Claimants for wrongful state actions, which effectively signal that, in the event of a dispute due to expropriation, there will be a more predictable outcome for both states and investors. Notwithstanding, there is still room for improvement in such decisions. For example, the standards used to provide monetary compensation equivalent to the restitution value in unlawful expropriation cases could be more uniform. At the current moment, unfortunately, we sometimes see diverging opinions. In some cases we have seen a legal criteria that favors granting the higher of damages calculated as of the date of expropriation versus the date of award (like in ADC v. Hungary), which makes economic sense in that such criteria is best suited to deter future opportunistic behavior by governments; yet in other cases, compensation equivalent to the restitution value as of a current date has been equated with an update on the value as of the date of expropriation plus interest (i.e. Vivendi v. Argentina).

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Q. How is your expertise as economist relevant in quantum opinions in commercial cases?

A: Commercial cases typically involve shareholder disputes, breaches of purchase agreements, revision to and triggering of M&A clauses, and all sorts of other business disputes that may require complex damage calculations. What I find most relevant and unique about the contribution of economists in these cases is their understanding of how companies compete in different market environments, and thus how pricing decisions and marketing and investment strategies are likely to have occurred in a but-for scenario. For example, in trying to understand how a price reopener clause would have operated under a long-term natural gas supply agreement, it might be critical to understand what would constitute a market price suitable as a marker or price reference. If such markers do not exist or are unsuitable, there might be the need to simulate supply/demand market equilibrium prices in environments that are not fully competitive. And this, in turn, might require a model of market behavior more consistent with oligopoly outcomes, which, despite being challenging, can be represented and explained in simple a form. Similarly, economists are well suited to use econometric techniques to conduct event studies and market capitalization methods. These are widely used in securities litigation to isolate causality elements when it comes to disputes that are related to companies that are publicly traded, and can be very useful in determining the scale of the harm.

Q. Many lawyers would say that Tribunals are improving in the way they decide complex issues of quantum. From your perspective as a seasoned expert, do you agree with this view?

A: I do agree, yes. Nowadays, most awards include exhaustive reasoning and justifications on issues of quantum. Some Tribunals not only seem to be very comfortable with using standard techniques in recurrent themes (such as how to derive a discount rate, or how to interpret a cash flow forecast), but also, and most importantly, they provide sound justifications to the choices made on each single parameter under dispute, even when sophisticated valuation models are at stake. There are however, outstanding issues that still concern the parties, for which there is room for improvement. For example, there's the fear of what I call "ad-hoc" rulings on quantum by some arbitrators. This happens when a Tribunal radically departs from the assumptions, parameters and sometimes even the methods proposed by the experts on both sides, and instead replaces them with assumptions or values based on their own thinking, and which might not be sound from an economic perspective. In doing so, arbitrators are taking a non-trivial risk and, to be quite frank, are doing a disservice to efforts to make arbitral decisions more predictable. I specifically still see inconsistencies across cases on the rates at which pre-award interest is granted, with little economic justification as to the choice made in each case.

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Q. Are Tribunals making the most of the economic and quantum experts?

A: Much to my pleasure, many arbitrators won't let you finalize your oral examination without exhausting all of their questions and needs for clarification on issues of damages. Overall, I would say that Tribunals could further benefit from having experts work for them (with or without the supervision of the lawyers) during post-hearing stages. Recently, I've had very positive experiences with arbitrators that have asked the opposing parties' experts to compute joint models, or provide tools so that the Tribunal can ponder the impact of alternative scenarios and assumptions under dispute. The use of joint models in post-hearing exercises could prove to be very useful, in particular when both sets of experts act professionally and in a collaborative manner – something that is not to be taken for granted.

Q. What would you say are the most problematic or controversial factors in which quantum experts rarely agree in investor-state arbitrations?

A: I'd say the hottest topic in town is the scope and size of the country risk premium that is added in the discount rate. As to the scope of what should be quantified in this premium, some experts assume an extreme interpretation of the legal instruction of "treaty protection" and therefore incorporate zero country risk exposure. This, in my opinion, is incorrect, as there is always some general degree of exposure to country risk, despite the protection of a treaty. However, the most common sin I've observed is the advocacy of a very high country risk premium based on the yield of sovereign bonds when emerging markets are either distressed or the country in question is in a near-default state. When this happens, the yield on these bonds reflects nothing but the (enhanced) default risk of the sovereign, and has little or no connection to the magnitude of the exposure or the perception of country risk that an investor faces in dealing with a transaction in the private sector. Finding common ground on these issues is of significant importance and is certainly an area in which I believe economists and financial experts could improve.

As I said earlier, this would facilitate a more reasonable decision-making process for Tribunals and will also add predictability to future arbitration proceedings as it would narrow the ranges of likely discount rate outcomes, which have a first-order impact on quantum.