CHAPTER 7

The Role of Damages Calculations in the Legitimacy of International Investment Arbitration

Catherine Amirfar

Introduction

Issues surrounding the calculation of damages in the investor-state arbitration context are among the most significant and underappreciated challenges facing the system of international investment arbitration. If the premise that “valuation is not what lawyers do” were true once—which I dispute—it cannot be true today. Billion-dollar claims, often of significant public policy importance, now routinely are brought in investment arbitration. The import of arbitrators applying the nuances of the law of treaty interpretation in a reasoned and transparent manner goes without saying. Less well-settled, but equally crucial for the legitimacy of the international dispute settlement system, is that practitioners understand the nuances of damages valuation disputes, and that arbitrators interpret and decide those nuances in a reasoned and transparent manner. To be clear, I am not suggesting that legal practitioners themselves should become full-fledged experts in financial economics, but I do believe that they must understand better the complexities of valuation.

From a practical standpoint, parties to international investment arbitrations routinely engage in years of drafting pleadings, hearings, collecting of evidence, retaining experts, and paying sizeable legal fees to prepare their cases on damages. To have a tribunal in its final award provide little or no reasoning for the adoption of one methodology or input variable over another, risks creating the perception that tribunals are effectively awarding damages based on ambiguous and amorphous conceptions of equity, with lip-service being paid.

1 Partner & Co-Chair of the Public International Law Group, Debevoise & Plimpton LLP. From 2014 to 2016, I served as Counselor on International Law, Office of the Legal Adviser, U.S. Department of State. The views expressed in this article are made in my personal capacity and are not necessarily the views of the U.S. Department of State or of the U.S. Government.

2 Markham Ball, “Assessing Damages in Claims By Investors Against States”, 32 ICSID Review—Foreign Investment Law Journal 408 (2001) (noting “valuation is not what lawyers do. The law establishes a standard. It is up to another discipline to assess the facts in light of that standard and produce a number.”).
to a valuation methodology to add a veneer of credibility. In egregious cases, damages awards with no supporting analysis are subject to attack. But even outside that admittedly rare circumstance, legal practitioners are often hard-pressed to explain to, for example, a senior government official, a general counsel of a Fortune 500 company, or even a student of Economics 101 an award citing to no reasoned basis to justify a quantum of damages that happens to fall just in between the parties’ two competing valuations. If States, parties, and observers perceive that the international investment arbitration system lacks rigor and certainty, that perception materially affects the enterprise of international investment arbitration as a whole. In short, valuation needs to be something that lawyers “do.”

A tribunal’s decision on damages not only impacts the ultimate quantum of compensation, but it often raises legal equities of particular importance to investment arbitration. Yet the economic and legal consequences of such decisions are often little discussed in tribunal awards. Critical economic issues drive many awards. For example, how should the valuation for an alleged expropriation claim treat the prospect of future expropriations by the respondent state? Should a respondent state with a higher risk of expropriation pay lower compensation to a winning claimant than for an identical asset in a state with lower risk of illegal sovereign acts? What incentives does the ability to benefit from their illegal conduct create? For another example, when and how should compound or simple pre- and post-award interest be available and on what basis? Should pre-award interest hinge only upon whether damages should properly account for the time-value of money, or should tribunals also consider whether interest awards are proper tools to disincentivize possible future illegal conduct by losing respondent states? What incentives for both expropriation and payment are created when post-award interest provides financing to state at rates lower than its sovereign borrowing cost?

One critical area where transparent reasoning often is lacking is in the determination of the applicable discount rate (“DR”) in the context of the commonly used discounted cash flow (“DCF”) method. For these purposes, I focus

---
