Energy, Asia & the Great Recession: Recent trends and issues in international arbitration
Wednesday, March 11, 2015 - 12:57
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The interdependence of global markets and the growth in cross-border transactions have increased the scale, complexity and frequency of international disputes. As these disputes become more complex, expert assessments of financial, economic and business matters have become increasingly important. This article discusses trends in the current international arbitration environment, as well as how the evolving landscape has affected the arguments considered by tribunals.

Overview

International arbitration takes two forms: (1) investor-state arbitrations that involve disputes between investors from one country and the government of another country in which they have invested, and (2) international commercial arbitration involving disputes between corporations of different countries.

In investor-state arbitrations, foreign investors claim that the host government adopted measures (including direct or indirect expropriation) that deprived them of the value of their investments. These investors bring their claims under the aegis of a bilateral investment treaty, an international investment agreement, a multilateral free trade agreement with investment protection provisions (e.g., the North American Free Trade Agreement), or a multilateral investment treaty (e.g., the Energy Charter Treaty). Typically, the outcomes of these cases are divided evenly among three possibilities: decisions in favor of the state, decisions in favor of the investor and settlements.

International commercial arbitration encompasses all commercial disputes in almost all industries. They are normally administered by specialized institutions, including, among others: the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), and the International Centre for Dispute Resolution (ICDR) of the American Arbitration Association (AAA). The latest available statistics suggest that close to 3,000 new arbitration cases are registered globally every year, with one-third filed at the ICDR. The LCIA has witnessed a 13.3 percent average annual growth rate from 2000 to 2007.

In a departure from the past, 40 percent of new cases in 2014 were against developed countries, compared to the historical average of 28 percent. Most of those cases were triggered by changes in the regulatory framework for the generation and distribution of electricity from renewable sources (particularly solar and eolic), which led to cancellations or assumed violations of contracts; and/or revocation or denial of permits, licenses or authorizations to operate.

This article focuses on four recent trends in international arbitration:
The Great Recession brought about a significant contraction of global trade – between 2008 and 2009, the volume of imports worldwide shrunk 22 percent. Foreign direct investment also contracted significantly – by 31 percent during the same period. These trends stimulated international arbitration: while the total number of new cases grew at an annual rate of 1.6 percent from 2000 to 2007, that number shot up 16 percent in 2008, and an additional 19 percent in 2009, before going back to its previous growth rate.

While trade has rebounded and is currently 15 percent above its previous maximum, foreign direct investment has been slower to recuperate overall, with the exception of Asia.

A noteworthy structural change that occurred during the recession is that China’s and India’s internal markets were large enough to partly shield them from the impact of the Great Recession, and that they became active contributors to cross-border transactions.

While the average annual growth rates of China’s imports and exports decreased following the recession (from 18.0 and 20.0 percent during 2000–2007 to 9.8 and 8.5 percent in 2008–2014), the post-recession rates of 9.8 and 8.5 percent were still above the worldwide averages of 5.9 and 6.2 percent. Similarly, India’s import and export growth rates remained above average during 2008 to 2014 (6.1 percent and 7.3 percent, respectively). Over the last twenty years, India’s foreign direct investment has grown sixfold, and China’s almost eighty times over. This trend has led to the increasing importance of the Singapore International Arbitration Centre (SIAC), as India and China are two of the most frequent nations of parties appearing in arbitrations before the SIAC. Over the period 2003 to 2013, the number of new cases before the SIAC quadrupled.

The amounts in dispute in international arbitration have risen over time, particularly in extractive industries such as minerals (e.g., gold or uranium) and hydrocarbons (e.g., oil and natural gas). The number of major claims (in the billion-dollar range) more than doubled between 2010 and 2014, and the estimated value of pending claims increased threefold. Recent major cases involving investor-state arbitrations include the $50 billion award to former shareholders of Russian oil company Yukos; the $1.8 billion award to Occidental Petroleum in its claim against Ecuador; and the pending cases by Conoco-Phillips and Exxon against Venezuela. In turn, the $2.2 billion award to Dow Chemical in its claim against a Kuwaiti company set a precedent in the space of commercial arbitrations.

Over the last decade, the level of sophistication of the arguments considered by tribunals has increased and damages calculations have become more complex – particularly in cases where hundreds of millions and billions of dollars are at stake. In the twentieth century, some tribunals used simple interest calculations, particularly for prejudgment interest awards. For the last decade and a half, most awards recognize that compound interest is the norm in
financial markets and thus reflect the damages suffered by the claimant. Likewise, in the past, some tribunals were not comfortable considering damages estimations that were forward looking and did not want to rely on a consideration of future profits. Today, the income and market approaches are displacing the "safer" and often inappropriate cost or accounting/book value approach. Some tribunals, for example, have expressed reluctance to employ the discounted cash flow (DCF) method unless the business or property in which the claimant invested was a "going concern" as of the valuation date. This is sometimes defined as a business that has an earnings history of at least two to three years.

While it used to be the case that quantum experts were supervised at law firms by senior associates, in large part as a result of pressure from clients, senior partners have become more and more involved in determining the scope of quantum experts’ assignments. This has led to an increasing demand for sophisticated analysis and presentation skills from experts who can explain complex issues in ways that are easy to understand. A host of complex issues now finds its way into quantum reports:

- What is the appropriate valuation date? Does it make a difference whether the expropriation was lawful or not?
- Is the choice of valuation date dependent on the valuation method?
- Should awards be grossed up?
- Are market distortions in input and output prices, interest rates or exchange rates appropriately reflected in the damages calculation? (In some cases, these variables are subjected to governmental control, e.g., dual exchange rates.)
- What is the importance of price distortions in the definition of the relevant market for damages purposes?
- What are the sources of a project risk and the steps that de-risk it?
- Are all of the sources of risk (e.g., project, execution, country, sector) reflected in the valuation through the weighted average cost of capital (WACC) or other methods (e.g., probability of success)?
- Is the leverage ratio used to calculate the WACC consistent with the rest of the valuation?
- Is option theory a useful damages estimation tool, particularly in the case of natural resources (minerals or hydrocarbons)?

Effective quantum experts are those who take all of these complexities into account and present them in a simple framework that clarifies for tribunals the major decision variables they have to rule on and the basis for those decisions. In the current international arbitration landscape, experts are not advocates but teachers.

José Alberro is a senior advisor and coheads Cornerstone Research’s international arbitration and litigation practice. Dr. Alberro has provided expert testimony in international arbitrations on four continents, involving both investor-state and commercial disputes. He has conducted arbitrations at the World Bank’s International Centre for Settlement of Investment Disputes and at the American Arbitration Association.

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