DAMAGES IN INTERNATIONAL ARBITRATIONS GUIDE

FIFTH EDITION

Editor
John A Trenor

Damages in International Arbitration Guide

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Preface

This fifth edition of Global Arbitration Review's *Damages in International Arbitration Guide* builds on the successful reception of the earlier editions. As explained in the Introduction, this book is designed to help all participants in the international arbitration community understand damages issues more clearly and to communicate those issues more effectively to tribunals to further the common objective of assisting arbitrators in rendering more accurate and well-reasoned awards on damages.

The book is a work in progress, with new and updated material being added to each successive edition. In particular, this fifth edition incorporates updated chapters from various authors and contributions from new authors. This edition seeks to improve the presentation of the substance through the use of visuals such as charts, graphs, tables and diagrams; worked-out examples and case studies to explain how the principles discussed apply in practice; and flow charts and checklists setting out the steps in the analyses or the quantitative models. The authors have also been encouraged to make available online additional resources, such as spreadsheets, detailed calculations, additional worked examples or case studies, and other materials.

We hope this revised edition advances the objective of the earlier editions to make the subject of damages in international arbitration more understandable and less intimidating for arbitrators and other participants in the field, and to help participants present these issues more effectively to tribunals. We continue to welcome comments from readers on how the next edition might be further improved.

John A Trenor
Wilmer Cutler Pickering Hale and Dorr LLP
November 2022

Introduction

John A Trenor[1]

There are three types of arbitrators: those who understand numbers and those who don't.

This old joke, adapted to the international arbitration community and repeated at conferences, typically receives nervous laughter from parties, counsel and experts who may have experienced innumeracy at first hand on the part of a tribunal. Yet this innumeracy is by no means limited to those who serve as arbitrators; the joke could equally be applied to those who appear as counsel and to other participants in the international arbitration community.

This book is aimed at everyone who gets the joke, whether they profess to understand numbers or not. The objective of the *Damages in International Arbitration Guide* is to help all participants in the international arbitration community – from the arbitrators to the parties to counsel and experts – understand damages issues more clearly and communicate those issues more effectively to tribunals to further the common objective of assisting arbitrators in rendering more accurate and well-reasoned awards on damages.

In the vast majority of international arbitrations, one or more parties seek damages. As such, damages are a critical component of most cases. A tribunal that misunderstands the relevant damages issues does not render justice to the parties. An award that effectively resolves the scope of liability but misunderstands, misapplies or miscalculates damages does not put the aggrieved party back in the position it would have been in if the wrongful act had not occurred. An award that seemingly takes a Solomonic approach by 'splitting the baby' or does

1 John A Trenor is a partner at Wilmer Cutler Pickering Hale and Dorr LLP.

not adequately explain the decision on damages does not typically satisfy either party and does not contribute to a favourable reputation for the arbitrators who issued the award.

Parties, and their counsel and experts, express frustration with awards that offer little reasoning on damages or, worse yet, faulty reasoning or errors in principle or calculation. Arbitrators express frustration with counsel and experts who struggle to communicate often complex damages issues clearly and effectively. Counsel and experts express frustration with each other on how best to present damages cases to tribunals that may lack quantitative backgrounds.

The idea for this book arose from discussions among members of the Global Arbitration Review editorial board, who have heard these frustrations being voiced and identified a void in the market for a guide to damages in international arbitration. This book draws on the insights of leading lawyers, experts and academics in the field to produce a work that will be a valuable desk-top reference tool for arbitrators, parties, and their advisers and counsel, when approaching damages issues in international arbitration.

This book is not intended to provide a comprehensive answer to every question. Frequently, the answer depends on the context – on the contract or treaty language, the applicable law, the arbitration agreement or rules, the facts of the case, etc. Indeed, on some issues addressed in this book, the authors (and the editor) no doubt disagree. Participation in this book is not meant to convey endorsement of the views expressed by others. However, the objective of this book, and indeed the objective of resolving disputes between parties regarding damages, is to understand better why they disagree. Is the disagreement based on differing views on what the contract, treaty or applicable law requires? Is it based on differing assumptions of the parties and their experts? Is it based on differing views of the appropriate methodology to assess and quantify damages? Or is it based on different quantitative models?

The aim of this book is to make the subject of damages in international arbitration more understandable and less intimidating for arbitrators and other participants in the field, and to help participants present these issues more effectively to tribunals. The chapters address key issues regarding various aspects of damages, identify areas of general agreement and disagreement, provide checklists and tips, and describe effective approaches to presenting and resolving damages issues. With a firm understanding of the underlying issues and the reason why the parties disagree, the arbitrators can make informed judgements on how to resolve those differences.

The book is divided into four parts.

Part I addresses various legal principles applicable to the award of damages. The chapters in this part include overviews of the civil and common law approaches to both compensatory and non-compensatory damages, and cover damages principles under the Convention on Contracts for the International Sale of Goods, contractual limitations on damages, principles for reducing damages, such as mitigation, and damages principles in investment arbitration. The authors of these chapters are counsel from leading international arbitration firms and legal academics.

Part II addresses various procedural issues regarding damages and the use of damages experts, including bifurcation, evidentiary issues such as document disclosure, and techniques and approaches to maximise the effectiveness of expert assistance on damages. The authors of these chapters are also counsel from leading international arbitration firms.

Part III addresses various approaches and methods for the assessment and quantification of damages. It includes an overview of damages and accounting basics, quantifying damages for breach of contract, the income approach (discounted cash flow methodology) and determining the weighted average cost of capital, the market approach (comparables), the asset-based approach, taxation and currency issues, interest, costs, and the use of econometric and statistical analysis. The authors of these chapters are experts from leading expert practices, and economic and financial academics.

Part IV addresses damages issues specific to certain industries or those that cut across multiple industries. These chapters include overviews of damages issues in energy and natural resources arbitrations, construction arbitrations, life sciences arbitrations, mergers and acquisitions and shareholder arbitrations and intellectual property arbitrations. The authors are again experts from leading expert practices and counsel from leading international arbitration firms.

In addition to the hard copy version of this book, the content is also available on the Global Arbitration Review website, with additional online materials identified by the authors. Online access is available to subscribers at www.globalarbitrationreview.com/insight/guides.

Many individuals have contributed to making this book a success and deserve thanks. First and foremost, the authors of the chapters have shared in the vision of helping participants in the international arbitration community understand damages issues better. Their valuable contributions help to achieve this goal.

The professional team at Global Arbitration Review and its publisher, Law Business Research, have worked tirelessly at all stages of the process, from conception of the idea, through the editorial process, to publication.

This book would also not have been possible without the ideas and support of numerous current and former colleagues at Wilmer Cutler Pickering Hale and Dorr LLP.

Global Arbitration Review's *Damages in International Arbitration Guide* will continue to be updated in future editions. Contributing authors will be encouraged to update existing chapters and new authors will be invited to contribute additional chapters. If readers wish to see further topics included or existing topics addressed in more detail, please bring them to my attention or to the attention of Global Arbitration Review. We also welcome comments from readers on how the next edition might be improved.

I share the hope of Global Arbitration Review that this book and future editions will form a valuable contribution to the field of international arbitration and that, in the future, the joke that there are three types of arbitrators (or counsel, or others) – those who understand numbers and those who don't – no longer resonates.

Part III

Approaches and Methods for the Assessment and Quantification of Damages

CHAPTER 20

Taxation and Currency Issues in Damages Awards

James Nicholson and Toni Dyson[1]

Introduction

This chapter describes some of the issues that can contribute to the distortion of the value of awards received by claimants arising from the treatment of taxes and currency, and explores some possible approaches to reducing or eliminating potential distortions from an economic point of view.

Taxes, and particularly taxes on profits, are a fact of corporate life in the majority of jurisdictions. As a result, the treatment of tax in the calculation of awards of compensation made by tribunals in international commercial and investment treaty arbitration can have a significant effect on the value of an award to a recipient. Overcompensation and under-compensation are possible if taxes are not considered appropriately, or at all.

The treatment of taxation in relation to awards of damages, depending on the circumstances, may be a question of the law of damages before it is a question of the assessment of economic loss. In the taxation part of this chapter, we focus on questions of economic loss arising in this context. These issues can be complex, given the nature of the calculation of an award, its timing and the international context in which many claims are made. Perhaps partly as a result, this area has often been given limited attention by tribunals and parties to disputes.

Similarly, the treatment of currencies in the calculation of awards of damages can have a very significant effect on the value of damages received by a claimant, again potentially giving rise to overcompensation and under-compensation.

1 James Nicholson and Toni Dyson are senior managing directors at FTI Consulting LLP.

Calculating damages in international arbitration

Famously, the calculation of an award of monetary damages in bilateral investment treaty (BIT) arbitrations is based on the principle established by the Permanent Court of International Justice (predecessor to the International Court of Justice) in the *Chorzów Factory* case of 1928: 'reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed'.[2] The *ex ante* position should be restored. A substantially similar principle generally applies in international commercial arbitration: that the claimant should be restored to the position it would have enjoyed but for the breaches found by the tribunal. We shall call this the 'principle of full compensation'.

The principle of full compensation implies that any award should restore the claimant to the same position that it would have enjoyed but for its injuries, taking account of all relevant factors, including applicable taxation and relevant currency movements, both in considering the financial position the claimant would have been in but for the breach or breaches, and the financial position in which it actually finds itself.

Tax treatment of arbitration awards

Why does tax matter?

Taxation of corporate profits is well established in most jurisdictions.[3] These taxes would often have applied to any additional profits a claimant would have made but for its injuries, and also often apply to any award received by a claimant.

The treatment of taxation by tribunals in setting awards can make an important difference to the net proceeds of an award to a claimant and, therefore, whether the principle of full compensation has been met. Put simply, if an award itself is subject to tax and the value of the award has been calculated by reference to profits lost on a post-tax basis, under-compensation of a claimant is likely to arise. In these circumstances, the principle of full compensation might imply, at its most straightforward, that it would be necessary for the claim to include a gross-up for tax payable on the award.

2 *Factory at Chorzów (Germany v. Poland)*, Merits, 1928 PCIJ (Ser. A) No. 17 (13 September) at [125].

3 Although individuals are often parties to international arbitration, we focus on the situation of corporations.

However, the question of tax is often largely and sometimes entirely disregarded by the parties to a dispute. The sources of this neglect are understandable:

- damages calculations are often already complex, time-consuming and expensive for the parties to prepare, before consideration of tax issues;
- tax is itself a complex area often requiring evidence from additional experts if it is to be examined in detail; and
- because the amount of taxes that would have been, or will be, paid in certain situations can depend on the performance in the future or hypothetical position of both the legal entity and its corporate group, treatment of tax issues may require an even broader scope for analysis and estimation than that required for other aspects of loss assessment.

Moreover, to assess the extent of taxes that a claimant will pay on any award, it is often necessary to make estimations concerning the future actual performance of the claimant (because, for example, a loss-making company may pay no taxes on an award, whereas the same company, if profitable, would pay taxes). When an estimation is compared with the future actual performance of a business it may result in dissatisfaction for one of the parties affected by an award of damages.

Below, we discuss some of the conceptual issues involved in considering the tax implications of damages awards, before giving an overview of tax issues in selected jurisdictions.

Issues raised by tax analysis

To illustrate the issues at hand, consider a relatively straightforward case in which a claimant is seeking compensation only for trading losses suffered in its home jurisdiction.

To analyse fully the tax treatment of the hypothetical lost profits, the following would need to be taken into account:

- Over which periods would the lost profits have arisen?
- What is the applicable corporation tax rate in each period?
- What is the basis of the calculation of taxable profits in each period (e.g., taking account of allowances, depreciation of assets for tax purposes and other factors)?
- To what extent are other losses available for offset either within the period, brought forward from earlier periods or surrendered from affiliates?

A similar analysis would be required in relation to the award claimed in compensation for the lost profits, which would need to take the following into account:

- On what basis will the award be subject to tax? Does it follow the taxation of the lost profits or is it treated as a separate source of income or gains subject to different rules?
- In which period would it be subject to tax? At the time of the claim, both the timing of any future award payment and the tax position of the claimant in the tax periods in which the award may be received are likely to be uncertain.

Further considerations come into play when the injury causes loss to an asset. Depending on the applicable jurisdiction, damage to an asset may result in a deemed disposal or part disposal of the asset for tax purposes, and any compensation for such a loss may be treated as proceeds of such a disposal. This may apply when the asset is tangible property, or intangible property such as a brand, which may be a recognised asset on the claimant's balance sheet. The capital gain or loss will be calculated according to applicable tax principles, deducting allowable costs (of acquisition, etc.) from the proceeds of disposal. This calculation may not be consistent with the method used to calculate the award, which may be by reference to loss of revenue, and this would need to be considered to ensure appropriate post-tax compensation.

Further refinement would be needed if a claimant is seeking compensation for profits that would have been generated partly or entirely in jurisdictions other than its home jurisdiction. This is very often the situation in BIT cases and for those commercial cases in which a parent company is claiming for losses suffered by its foreign subsidiaries.

Although international law may apply to the arbitration process, tax law is not international. Each jurisdiction has sovereign power to determine the taxation of companies resident or active in that jurisdiction. The exercise of this sovereignty can result in conflict with other jurisdictions or supranational bodies, as demonstrated by the intervention of the European Union in Apple's tax arrangements in Ireland, agreed by the Irish fiscal authority but attacked under EU State Aid principles. The diversity of approach to taxation generally is illustrated by the table

below, which summarises headline corporation tax rates by country.[4] The method of identification of the profits subject to tax, taking account of reliefs, exemptions, losses and affiliated company tax positions, also varies.

Corporation tax rates in selected jurisdictions (2022) (excludes local tax charges)

Jurisdiction	Corporation tax rate
China	25%
France	25%
Germany	15%
Hong Kong	16.5%
Ireland	12.5%
Singapore	17%
Switzerland	8.5%
United Arab Emirates	0%*
United Kingdom	19%†
United States	21%
Venezuela	34%

* UAE has introduced a corporation tax regime at 9%, starting from June 2023
† UK is due to raise the headline rate of corporation tax to 25% from April 2023

In cross-border cases, therefore, it is necessary to consider whether there is symmetry of taxation between the lost profits on one hand (hypothetically subject to tax in the home jurisdiction of the injured company) and the award on the other hand (potentially taxable as income or capital gains when received by the injured company or an affiliate in another jurisdiction).

This situation also raises the question, in relation to commercial cases, of equity between jurisdictions, as well as between claimant and defendant; when tax is lost in one jurisdiction as a result of an injury inflicted on one company and paid in another jurisdiction as a result of compensation paid to a parent or affiliate in that other jurisdiction, some form of settlement might be expected between tax authorities in different jurisdictions. However, there is no mechanism in the

4 See Organisation for Economic Co-operation and Development, Tax Database (https://www.oecd.org/tax (last accessed 28 September 2022)); Trading Economics (www.tradingeconomics.com (last accessed 28 September 2022)); and KPMG corporate tax rates table (https://home.kpmg/sg/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (last accessed 28 September 2022)).

established tax treaty system for tax fortuitously received in one jurisdiction to be reimbursed to another, so this type of process is not yet formally possible, in commercial cases at least.[5]

There is also the possibility of a claimant receiving an award calculated on a pre-tax basis, which is then not subject to tax; for example, if circumstances change or an alternative tax return position is taken. Such over-recovery would also be a violation of the principle of full compensation.

Perspectives from United Kingdom, United States and France

As the brief survey above indicates, the issues involved are complex, and a detailed analysis of tax issues risks creating a separate arbitration within the arbitration, requiring further evidence of fact and evidence from tax experts, among other things. We have never sensed an appetite from parties or tribunals for such a detailed investigation, which is understandable given the potential for excessive technical detail, creative assumptions and uncertainty of tax outcomes outside the control of the tribunal.

Before we discuss the steps that parties and tribunals can take towards implementing the principle of full compensation as far as taxation is concerned, we explore certain perspectives arising in the United Kingdom, the United States and France.

UK perspective

The case of *British Transport Commission v. Gourley*[6] confirmed a general principle of compensation consistent with the principle of full compensation. However, the degree of approximation with which this principle is applied to the treatment of taxation on damages is variable.

The UK corporation tax treatment of an award of compensation is determined by the nature of the loss to which the award refers. When corporate trading activity has been damaged, and the award is calculated by reference to the loss of trading profits, it will be treated as taxable trading income. The timing of taxation of an award is likely to follow the period in which the award is recognised in the recipient's accounts.

5 Although see below for the tax treatment in France (and potentially other jurisdictions) of compensation for expropriations, as may be awarded under a bilateral investment treaty and otherwise.

6 [1955] UKHL 4, 3 All ER 796.

When compensation is claimed for damages other than loss of trade profits, it is necessary to determine whether the claim is in respect of a capital or revenue loss, and for capital losses, whether the loss relates to an underlying asset treated as chargeable for corporation tax purposes. A significant body of case law addresses the capital or revenue distinction, and UK statute defines chargeable assets. The area is complex and the facts will determine the UK tax treatment.

When compensation is claimed for permanent damage or deprivation of use of a fixed capital asset, it is possible that an award will be treated as a capital receipt. The tax treatment of the award will then be determined by whether the damage can be related to underlying property that is a chargeable asset for the purposes of calculating corporation tax on disposal (e.g., plant and machinery). In such cases, an award may be considered a deemed disposal or part-disposal of the asset, and a capital gain or loss would then arise for corporation tax purposes. It was established in the case of *Zim Properties*[7] that the right to take court action in pursuit of compensation or damages is of itself an asset for capital gains tax purposes. This case concerned damages for professional negligence and, under current UK practice, a punitive tax cost can arise.

Intangible assets such as goodwill were also historically treated as chargeable assets for corporation tax purposes; however, specific rules now apply to intangibles acquired (from third parties) or created after April 2002, such that gains or losses on disposal will be treated as revenue income or loss.[8]

A capital receipt not related to an underlying chargeable asset will not be subject to corporation tax under general principles. However, the basis on which receipts are characterised as non-taxable capital is dependent on the underlying facts, subject to a wide range of case law precedent and, therefore, not clearly defined.

A UK-based claimant, therefore, would need to identify the nature of the lost profits (whether capital or revenue) to analyse the tax treatment of the amount claimed. To restore the *ex ante* position, the calculation of the amount of the award should take account of the tax treatment of both the loss and the award itself.

7 *Zim Properties Ltd v. Proctor*, 58 TC 371.

8 The taxation treatment of intangible assets, including goodwill, is now dealt with by the Corporation Taxes Act 2009, Part 8: Intangible Fixed Assets.

US and French perspectives

US courts have approached the issue of taxation of arbitration awards in the context of employment tribunal cases adopting a 'make whole' purpose that is broadly consistent with the principle of full compensation.[9] These anti-discrimination cases are not directly relevant to the discussion relating to international commercial and investment treaty awards, but some insightful guidance emerges, such as the tribunal's emphasis on the significance of the particular facts of each case and placing the burden of proof on the claimant to establish any adverse tax consequences to be taken into account.

Turning to investment treaty cases involving US-based claimants, the award in the case of *Chevron and Texaco v. Ecuador*[10] included lengthy analysis of the tax consequences in Ecuador of profits lost. After the Republic of Ecuador agreed that no further tax, penalties or interest would be payable on the award, the award was calculated net of tax. In *Corn Products v. Mexico*,[11] the net-of-tax award was made to a US parent rather than to the Mexican subsidiary, to ensure no additional taxes were payable in Mexico. It is not clear whether US taxes would ultimately have been payable by the claimants in these cases or whether this was relevant in the calculation of the award. If the awards were subject to tax in the United States, the *ex ante* position may not have been restored unless the profits lost in Mexico would also ultimately have been subject to US tax.

A final point of fairness arises in the context of investment treaty awards (analogous to the point above relating to jurisdictional fairness in commercial cases). In the case of the expropriation of a company by a government, the value taken by the expropriating government is as a first approximation of the after-tax value of the relevant entity. If an award against a government based on the pre-tax value of the entity is paid to the parent company, as is often the case for BIT awards (on the grounds that the award will be taxed in the parent company's jurisdiction), then the losing government will pay an award greater than the value taken. The excess between the value taken and the amount paid would then effectively be a tax windfall for the government of the parent company's jurisdiction.

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9 *Eshelman v. Agere Systems Inc.*

10 *Chevron Corporation (USA) and Texaco Petroleum Company (USA) v. Republic of Ecuador* (March 2010), PCA Case No. 2009-23, cited in Nhu-Hoang Tran Thang, 'Tax Gross-Up Claims in Investment Treaty Arbitration' (February 2011).

11 *Corn Products International Inc v. United Mexican States* (March 2010), ICSID Case ARB(AF)/04/1, cited in Nhu-Hoang Tran Thang (op. cit. footnote 9).

It is perhaps to guard against such an outcome that the French General Tax Code stipulates that the French state will levy no taxes on awards paid in relation to expropriation or similar measures by a foreign government.[12]

Calculating tax impact in practice

One approach often used by a claimant is to quantify its claim before deducting any corporation taxes the affected entity would have paid, on the grounds that any award will itself be taxed, leaving the claimant's net position in line with the principle of full compensation. This approach is appropriate if the taxation of the lost profits would have been broadly in line with taxation of the award, both by reference to the method of calculation and marginal tax rate for the periods in question.

An alternative approach that is also often used is for a claimant to state its claim after deducting the taxes the entity would have paid, and to leave it to the tribunal to award the amount that would constitute full compensation post-tax. This approach essentially defers the question of taxation to the hearing or post-hearing stage. Such an approach would be appropriate if it is clear that the award itself would not be subject to tax. However, when the tax treatment of the award is not addressed at all, the claimant would be at risk of under-compensation.

As the great John Maynard Keynes[13] was reported (after his death) to have said: 'It is better to be roughly right than precisely wrong.' In view of the limitations of the above approaches, it may improve the appropriateness of a given award at an acceptable cost to pursue the issue of taxation slightly further, to move in the direction of the 'right' award, than to leave this undone.

Given the complexities involved in assessing taxes, even at a relatively simplified level, it is likely to be useful to secure the input of individuals with hands-on experience of tax assessment in the relevant jurisdictions, to validate the approach being undertaken. This input may come from the parties' own finance teams or existing external taxation advisers. Several consulting firms active in the assessment of losses in international arbitration, including the authors' own firm, have tax groups that also offer expertise in this area.

12 Article 238 *bis* C.

13 John Maynard Keynes (1883–1946) is regarded as the founder of modern macroeconomics.

Arbitration awards and currency

Why does currency matter?

Issues of currency arise very frequently in assessing losses in international arbitration. The critical issue is not so much the currency in which any award is to be paid – unless the currency is truly exotic (unlikely) or subject to exchange controls (at least sometimes explicitly ruled out),[14] a payment in one currency can today be quickly and very cheaply exchanged into another currency if the recipient wishes. The critical issues instead, are the currency in which the award is to be calculated and the dates on which any amounts in other currencies are to be translated into the award currency.

The following example (which mirrors several of the authors' recent cases) illustrates the effect this can have. Consider a loss suffered most immediately in a local currency, of 100 million currency units, and an award five years later. During the intervening period, local currency interest rates have been at 10 per cent, euro interest rates at 5 per cent and the exchange rate has depreciated from 10 to 20 local currency units to the euro, all as shown in the table below.

	Loss calculated in local currency			**Loss calculated in euros**		
	Local currency value	**Exchange rate**	**Euro value**	**Local currency value**	**Exchange rate**	**Euro value**
Loss at date of breach	100 million	10	10 million	100 million	10	10 million
Interest rate	10%					5%
Years to payment of award	5					5
Award including interest	161 million	20	8.1 million			12.8 million

Assume further that it is no contention between the parties that the award is to be paid in euros.

14 Sergey Ripinsky and Kevin Williams, in their book *Damages in International Investment Law* (British Institute of International and Comparative Law, 2008), cite the tribunal in *Vivendi v. Argentina* (ICSID Case No. ARB/97/3), and the Iran-US Claims Tribunal, both of which state that it is the 'frequent' or 'usual' practice of tribunals to provide for payment of damages in a convertible currency (footnote 2 to Chapter 10).

Straightforwardly, the euro value of the loss at the date of breach was €10 million. The respondent argues that the award is to be paid at the euro equivalent of the loss after it has been assessed in local currency and brought forward at the applicable rate of interest. Using this approach, the value of the award when paid is €8.1 million, as shown above (this is lower than the €10 million value of the loss at the date of breach, because the effect of the weakening of the local currency exchange rate more than offsets the relatively high interest rate).

The claimant argues, however, that the correct approach is to translate the loss into euros at the date of breach, using the then prevailing exchange rate, and then to add interest to the present. This gives rise to an award of €12.8 million, more than 50 per cent higher than the figure proposed by the respondent.[15]

The approach to currency selected by the tribunal, therefore, will have a significant effect on the amount recovered by the claimant. The effects of this general point can be far more dramatic than the illustrative example above; one case that was ultimately decided by the UK's House of Lords involved an award of the local currency equivalent at the date of payment of US$20,000 that would have been nearly US$3 million if translated into dollars at the date of breach.[16]

Legal approaches to currency and damages

The evolution of English law relating to currency and damages further illustrates the importance of this issue. For much of the 20th century, English law held that damages awarded in the English courts must be awarded in pounds sterling.[17] Damages claimed in contract law were to be converted into pounds sterling at the date of the alleged breach, disregarding subsequent fluctuations in relevant exchange rates.

15 If the local currency had appreciated, the reverse would apply and the claimant would be better off under the former approach.

16 *Attorney General of the Republic of Ghana v. Texaco Overseas Tankships*, The Texaco Melbourne, cited in *McGregor on Damages* (18th edition, McGregor, Sweet & Maxwell, 2009), 16-045.

17 We have no legal training on these issues; our understanding of the English law on currency and damages is derived in general from *McGregor on Damages* (op. cit., footnote 15), Chapter 16, at 16-019.

Although this treatment may be appropriate for a claimant predominantly doing business in pounds sterling, it exposes claimants operating primarily in other currencies to fluctuations in the value of the pound, in the same way as in the example above. This benefited the claimant at the expense of the defendant when the value of the pound appreciated during the relevant period by more than the differential between the applicable interest rate in each currency, and vice versa. During the Bretton Woods era of pegged exchange rates,[18] currency fluctuations, and hence the risks thereby imposed on parties to disputes, were very limited, apart from occasional devaluations. However, with the emergence of floating exchange rates from 1968, the associated risks grew.

The practice changed in two steps. The first step arose in 1974 when the Court of Appeal of England and Wales confirmed an award by commercial arbitrators expressed in a foreign currency, which had for some time been the practice among commercial arbitrators in appropriate circumstances.[19] Then, in 1975, the House of Lords, citing the development of floating exchange rates, explicitly repudiated the principle that claims for damages must be expressed in sterling.[20] From that point forward, claims for breach of contract under English law could be expressed in foreign currency; if any conversion was needed for enforcement purposes, it would take place at the date the court authorised the claimant to enforce the judgment (the date of payment).[21] This decision reduced the scope for foreign exchange rate movements to affect parties to a dispute inappropriately.

This then leaves the question, often hotly disputed in international arbitration today, of the currency in which to express an award. The English law approach, as summarised in *McGregor on Damages*, starts with an examination of the relevant contract; however, the mere fact that payments under the contract are to be made

18 The Bretton Woods system included a collective international currency exchange regime that was in place from the mid-1940s to the early 1970s.

19 *Jugoslavenska Oceanska Polvidba v. Castle Investment Co Ltd*, 1974.

20 *Miliangos v. George Frank Textiles*, 1975.

21 All as outlined in more detail in *McGregor on Damages* (op. cit. footnote 15), at 16-028.

in a particular currency does not necessarily imply that that is the appropriate currency for the award of damages.[22] The correct treatment, per Lord Wilberforce, is that damages should be calculated:

> *in the currency in which the loss was felt by the plaintiff or 'which most truly expresses his loss'. This is not limited to that in which it first and immediately arose. In ascertaining what this currency is, the court must ask what is the currency, payment in which will as nearly as possible compensate the plaintiff in accordance with the principle of restitution, and whether the parties must be taken reasonably to have had this in contemplation.*[23]

Under this principle, for example, a loss suffered by a French charterer under a contract denominated in dollars, for delivery to Brazil of goods that were damaged as a result of a breach by the shipowner, was subject to an award in French francs, because the charterer had had to use French francs to buy the Brazilian cruzeiros with which to compensate the cargo receiver.[24]

International courts and tribunals, as noted above, have consistently expressed compensation in freely convertible currencies. So, for example, in *Biloune v. Ghana*,[25] the claimants were compensated in relation to investments made in pounds sterling, Deutschmarks, US dollars and Ghanaian cedis (the latter not being freely convertible). The tribunal awarded compensation in the first three currencies but awarded the fourth amount in US dollars.[26]

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22 *McGregor on Damages* (op. cit. footnote 15), at 16-038.

23 Commenting on *Services Europe Atlantique Sud (SEAS) v. Stockholms Rederiaktiebolag SVEA*, often known as The Folias, as quoted in *McGregor on Damages* (op. cit. footnote 15), at 16-039.

24 The Folias, per *McGregor on Damages* (op. cit. footnote 15), at 16-037.

25 *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, Award on Damages and Costs, 30 July 1990.

26 Award on Damages and Costs of 30 June 1990, as quoted in Ripinsky and Williams, *Damages in International Investment Law*, op. cit. note 13, p. 395.

In selecting the appropriate convertible currency (or currencies) for an award, international law reached similar conclusions to English law at an earlier point in time but, perhaps not surprisingly, they are not as systematically applied. The tribunal in the *Lighthouses* arbitration between France and Greece stated in 1956:

> *The injured party has the right to receive the equivalent at the date of the award of the loss suffered as the result of an illegal act and ought not to be prejudiced by the effects of a devaluation which took place between the date at which the wrongful act occurred and the determination of the amounts of compensation.*[27]

Other institutions, including the United Nations Compensation Commission and the Iran–US Claims Tribunal, have adopted a similar approach.

Sergey Ripinsky and Kevin Williams note several mechanisms that have been used by international tribunals to implement this principle in cases in which the foreign exchange value of one of the possible currencies of the award had depreciated by more than any differential in the applicable interest rate. First, and as discussed above, the loss can be converted into the currency of the investor at the date of the breach. This was the approach taken by the tribunal in *Sempra Energy v. Argentina*,[28] after the Argentine peso fell against the US dollar to less than one-third of its value at the date of the breach. Second, and rather more unusually, the loss could be assessed in some third currency that has not depreciated – Ripinsky and Williams give the example of the 1956 *Lighthouses* arbitration between France and Greece, which related to events in the 1920s, since when the French franc had depreciated by 90 per cent and the Greek drachma by even more. This tribunal accepted the claimant's request to use the US dollar, which had been relatively stable in value during this period, as the money of account. Third, and even more unusually, some special adjustment could be made by the tribunal – for example, in *SPP v. Egypt*,[29] the tribunal adjusted the amount awarded in US dollars for the (relatively high) general dollar price inflation that had applied between the 1978 breach and the 1982 award, using the change in

27 id.

28 *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007.

29 *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award, 20 May 1992.

the US Consumer Price Index.[30] Finally, compensation may still be made in the depreciating currency if the associated award of interest is sufficient to offset the effect of foreign exchange depreciation.[31]

Valuer's approach to treatment of currency in damages awards

Absent specific instruction, and as with questions of taxation, the valuation expert will assess currency issues by reference to the principle of full compensation, by assessing the financial position of the claimant but for the breach, and comparing that to the financial position of the claimant in actuality. The effects of taxation on an award calculated in one currency by reference to a loss suffered in another, and associated currency differences, may also need to be considered to achieve full compensation.

To implement this principle, a valuation expert must form a view as to the likely use by the claimant of the cash flows lost due to the breach. It would seem that this involves grappling, from a valuation point of view, with the same issues as those addressed under English law when an arbitrator or judge considers 'which [currency] most truly expresses [the claimant's] loss'.[32]

A valuation expert may be able, however, to bring financial evidence relevant to addressing this question of which currency most truly expresses the claimant's loss. Examination of a claimant's financial statements or other accounting information may allow a valuer to test assertions made by the claimant relating, for example, to the currency mix of a claimant's revenues, costs, assets and liabilities, to a company's foreign exchange hedging strategy and other relevant elements.

Moreover, if a loss relates to a lost stream of cash flows – as in the case of most lost profits assessments, some expropriations, and many cases in which losses are assessed as of a present date rather than as a value of a business or asset at a past date – then the timing of those lost cash flows may be doubly important. In the first place, this is because, as in any assessment of loss, the later in time a loss in a particular currency is felt, the less the value of that loss in that currency at the date of assessment. Second, however, because if for award calculation purposes each lost cash flow is translated into the second currency at the date it would have been incurred, then the date of each lost cash flow will determine the exchange

30 The manner of awarded interest in dollars in this matter being inadequate to make such compensation.

31 See Ripinsky and Williams, in *Damages in International Investment Law*, op. cit. note 13, Section 10.1.2, for further discussion of these points.

32 See footnote 23.

rate that is applicable. The interaction of the timing of the lost cash flows with movements in the relevant exchange rate may have a major effect on the overall value of the claim.

Finally, the international law examples cited above focus on methods to insulate claimants against situations in which depreciation in the currency of the respondent state would reduce the value of an award to the (inappropriate) detriment of the claimant. However, it can arise that the respondent state's currency appreciates rather than depreciates after the date of the breach. From a valuation expert perspective, the principle of full compensation would insulate claimants from any associated benefit – as in the case of currency depreciation, the loss would be translated into the award currency at the date it was felt. To do otherwise would be to give claimants a one-way bet on currency movements subsequent to the date of breach – a one-way bet with a potentially significant financial value that could, in principle, be quantified using options-pricing techniques.

Case study

Tax

In a breach of contract case, the claimant's lost profits were estimated by computing the profits the claimants would have earned absent the respondent's breach. The operating currency of the affected entity was the US dollar and the claimant's other activities are all denominated in the Singapore dollar, and we initially assume the lost profits would, but for the breaches, have translated each year from US dollars into Singapore dollars. The lost profits are quantified by discounting them to a date of assessment (1 January 2022) using the claimant's Singapore dollar weighted average cost of capital (WACC), which we assume to be 8 per cent.

Claimant's losses (S$ millions)

Year	Lost profits (after tax)	Discount factor (S$, 8%)	Discounted lost profits (S$, after tax)
Key	A	B	A*B
2022	100	0.93	93
2023	120	0.86	103
2024	140	0.79	111
2025	160	0.74	118
2026	180	0.68	123
Total			**547**

Currency

The above lost cash flows are consistent with an assumption that the losses in US dollars would have been converted into the claimant's currency, the Singapore dollar, at each year's exchange rate and then discounted to the date of assessment at a discount rate denominated in Singapore dollars.[33] This is shown in the table below, which expands on the claimant's losses table, above.

Claimant's losses – translated to Singapore dollars year by year (S$ millions)

Year	Lost profits (US$, after tax)	S$/US$	Lost profits (S$, after tax)	S$ discount rate (8%)	Discounted lost profits (S$, after tax)
Key	A	B	C=A*B	D	C*D
2022	74	1.35	100	0.93	93
2023	90	1.33	120	0.86	103
2024	103	1.36	140	0.79	111
2025	117	1.37	160	0.74	118
2026	130	1.38	180	0.68	123
Total as of 2022					**547**

Alternatively, the claimant might argue that the lost cash flows would have been kept in US dollars throughout the period of loss – perhaps reinvested in this or another venture of the claimant's group. In such a situation, the lost profits would be calculated as a lump sum in 2022 money of US$414 million by applying a US dollar-denominated discount rate, which we assume to be 7 per cent, and then exchanged into the claimant's currency of Singapore dollars at the January 2022 exchange rate of S$1.35 per US dollar, to give a loss of US$559 million.

33 To derive the Singapore dollar-denominated WACC, we applied the international fisher effect by applying the relative inflation between Singapore and the United States to the US dollar-denominated WACC of 10 per cent (9.44% = [(1+10%) *(1+1.48%)/ (1+2%)] - 1). The forecast inflation rates in Singapore and the United States in 2027 are 1.48 per cent and 2 per cent, respectively. Source: IMF World Economic Outlook Database, April 2022.

Claimant's losses – assessed in US dollars and translated to Singapore dollars at date of assessment (S$ millions)

Year	Lost profits (US$, after tax)	US$ discount rate (7%)	Discounted lost profits (US$, after tax)	Exchange rate (S$/US$)	Value in claimant currency (S$)
Key	A	B	C=A*B	D	C*D
2022	74	0.93	69		
2023	90	0.87	79		
2024	103	0.82	84		
2025	117	0.76	89		
2026	130	0.71	93		
Total as of 2022			**414**	**1.35**	**559**

Which of these two approaches to currency is more appropriate is a question of fact and expert evidence as to the more realistic assumption regarding the use to which the claimant would have put the lost cash flows if it had received them. In the above example, the claim amount is higher in the second situation in which losses are assessed as a lump sum in US dollars as of 2022 and then translated into Singapore dollars. However, in general, either approach could lead to a higher claim, depending on the facts surrounding the case in question.

APPENDIX 1

About the Authors

James Nicholson

FTI Consulting

James Nicholson has more than 25 years' experience as a consultant on matters of finance, strategy and economics. Since 2005, his work has primarily involved issues of the identification and valuation of lost profits, and the valuation of businesses, financial assets including shareholdings, and other assets, and of wasted costs.

He has testified more than 45 times before commercial and investment treaty arbitration tribunals and national courts. James is a member of the Executive Committee of the Foundation for International Arbitration Advocacy, from 2014 to 2021 was president of the Standing Committee of the International Chamber of Commerce's (ICC) International Centre for ADR, and has been cited on a point of valuation by the Swiss Federal Supreme Court.

James is a CFA charter holder, and holds a master's degree in public policy from the Harvard Kennedy School, where he was a Fulbright Scholar. James was awarded first-class honours in his BA from Oxford University in philosophy, politics and economics.

Since 2015, James has been identified by Who's Who Legal as one of the 'Most Highly Regarded Individuals' and 'Global Elite Thought Leaders' in Europe and latterly Asia in its annual listings of the leading expert witnesses. In *Arbitration 2022 – Expert Witnesses*, Who's Who Legal quotes clients as saying: 'James has impressive writing skills – his reports are easy to follow, on point and very-well written'; 'He displays great attention to detail and the ability to digest vast dockets and organise them in a tribunal-friendly manner'; and 'His performance on the stand is exceptional'.

https://www.linkedin.com/in/james-nicholson-fticonsulting

Toni Dyson
FTI Consulting

Toni Dyson is a senior managing director in the FTI European tax advisory group and is based in London.

Toni has more than 25 years' experience in providing tax compliance and reporting services to FTSE 100 companies and UK subsidiaries of US-listed companies.

Toni's areas of expertise include all aspects of compliance and tax accounting, including the preparation of the tax provision to be recognised in the statutory accounts and agreement with the company's auditor, the preparation and submission of corporation tax computations and returns, quantification and recognition of tax assets and forecasting group tax positions to maximise tax opportunities, as well as UK corporate tax restructuring and planning.

Toni acted as tax compliance expert in *Altus Group v. Baker Tilly Limited*.

Toni is a member of the Institute of Chartered Accountants in England and Wales and a member of the Chartered Institute of Tax. She graduated from the University of East Anglia with a BSc in chemistry.

https://www.linkedin.com/in/toni-dyson-2014555/

FTI Consulting
One Raffles Quay
#27-10, South Tower
Singapore, 048583
Tel: +65 6506 9889
(Mobile) +65 9248 7670
james.nicholson@fticonsulting.com

200 Aldersgate
Aldersgate Street
London, EC1A 4HD
United Kingdom
Tel: +44 20 3727 1145
(Mobile) +44 7748 645 196
toni.dyson@fticonsulting.com

www.fticonsulting-emea.com

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