ARTICLE

Interest on damages and the discontinuation of LIBOR

Is now the time to revisit the choice of interest rate for interest awards?

Tim Battrick and Tim Richards of FTI Consulting's Economic and Financial Consulting practice review potential approaches to calculating pre-award interest in international arbitration, including the use of LIBOR. With the discontinuation of LIBOR from 2021, they set out a potential economic framework for determining the appropriate interest rate.

It can take a long time to resolve a dispute. As a result, a claimant may receive damages many years after suffering its loss. Claimants often claim interest as a result of this delay.

Albert Einstein is rumoured to have described compound interest as 'the most powerful force in the universe' and the eighth wonder of the world. While he may not have had awards of interest on damages in mind, the interest element of an award can be a significant part of the overall outcome of an arbitration. One example is the 2016 arbitration award in *Crystallex v Venezuela*, where the Tribunal awarded interest at a rate of USD 6-month LIBOR + 1% on damages of USD 1.2 billion, with interest accruing from April 2008.[1] Crystallex is currently seeking to enforce the award before the United States courts, and we estimate that approximately USD 350 million of interest has accrued.[2]

The right approach to an award of interest may depend on matters of fact, law and economics. However, despite the amount at stake, interest can often receive relatively little discussion in the parties' statements of case and in the Tribunal's award.

It is relatively common for Tribunals to award interest at a rate based on LIBOR, often with some premium applied. Our review of publicly available ICSID awards indicates that about one-third of interest awards are based on LIBOR. However, LIBOR will begin to be discontinued from the end of 2021[3] and so parties, experts and Tribunals will no longer be able to rely on it as a reference rate.[4] This provides a timely opportunity to reflect on the purpose of an award of interest on damages and how best to achieve that purpose.

1 See *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award dated 4 April 2016, paragraph 961.

2 The award specifies that interest should be calculated based on USD 6-month LIBOR + 1% with annual compounding. It does not specify whether interest should be calculated using average LIBOR each year or LIBOR on the annual compounding date. Our estimate reflects the average LIBOR each year.

3 It was recently announced that some tenors of USD LIBOR may continue to be published until June 2023.

4 The discontinuation of LIBOR may have implications for ongoing arbitrations (not just future ones). For example, if interest will continue to accrue until payment of the award and that payment does not take place until after LIBOR has been discontinued, it will be unclear how interest after this date should be assessed if the interest rate is based on LIBOR.

In this article we focus on pre-award interest which compensates the claimant for the passage of time between the date of assessment and the date of the award. Many Tribunals also award post-award interest. The right approach is a matter of law but, in our experience as valuation experts, post-award interest is often calculated at the same rate as pre-award interest.

LIBOR in interest awards

Introduction to LIBOR

The London Interbank Offered Rate ('LIBOR') is a widely used reference rate for various financial transactions, including loans and derivatives. It represents the interest rate at which large international banks can borrow funds from one another in the wholesale (i.e. interbank) funding market in London.

LIBOR is currently published across five currencies (USD, EUR, GBP, JPY and CHF) and seven maturities (overnight, one-week, one-month, two-month, three-month, six-month and one-year).

The use of LIBOR in interest awards

LIBOR is a popular reference rate for calculating pre-award interest – indeed, some investment treaties require interest to be calculated based on LIBOR.[5] Awards of the form 'LIBOR + X%' are common (a 2% premium seems to be particularly widely used). A premium to LIBOR is generally considered to reflect the difference between the cost of borrowing of banks and other types of businesses.[6]

The common use of LIBOR + X% gives lawyers, experts and Tribunals an easy reference point when assessing interest. For example, in *Joseph Houben v Burundi*, the Tribunal explained its interest award simply by stating:[7]

> *"the LIBOR rate in US dollars at 6 months + 2% constitutes a reasonable rate frequently applied by arbitration tribunals ruling on investment matters"*

The discontinuation of LIBOR

As has been well documented, investigations by various central banks, regulators and prosecutors in various countries have found that certain banks have manipulated LIBOR, and have issued substantial fines.[8]

This has contributed to the UK Financial Conduct Authority (the regulator of LIBOR) announcing that LIBOR will begin to be discontinued from the end of 2021.[9]

The discontinuation of LIBOR has implications for interest awards. In the case of *Yukos v Russia*, the Tribunal rejected an interest rate based on LIBOR because "*LIBOR … has been discredited*".[10] Similarly, in *Magyar Farming v Hungary*, the Tribunal awarded interest based on EURIBOR rather than LIBOR (EURIBOR reflects the borrowing rates for banks in the Eurozone, while EUR LIBOR reflects the euro-denominated borrowing rates for banks in London).[11] The Tribunal adopted this rate because:[12]

> *"LIBOR is likely to be phased out in 2022, with the result that the computation of interest may be rendered impossible beyond that date"*

Regulators have identified alternative benchmark rates including 'SOFR' (as an alternative for USD LIBOR), 'SONIA' (as an alternative for GBP LIBOR) and '€STR' (as an alternative for EUR LIBOR).[13] However, these alternative benchmark rates do not provide a like-for-like replacement for LIBOR.[14] Like LIBOR, they are interbank lending rates. However, they are overnight rates while LIBOR is available for maturities of up to one year.[15] In our experience, awards based on LIBOR typically reference six-month or one-year LIBOR rates and we are not aware of any awards that reference overnight LIBOR.

5 For example, in *Siag & Vecchi v Egypt*, interest was awarded based on six-month LIBOR in accordance with the Italy-Egypt BIT. See *Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award dated 1 June 2009, paragraph 597.

6 For example, in *Lemire v Ukraine*, the Tribunal awarded interest at LIBOR + 2%, finding that "*LIBOR reflects the interest at which banks lend to each other money. Loans to customers invariably include a surcharge, and this surcharge must be inserted in the calculation of interest*". See *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Award dated 28 March 2011, paragraph 355.

7 Translated from the original French. See *Joseph Houben v Republic of Burundi*, ICSID Case No. ARB/13/7, Award dated 12 January 2016, paragraph 258.

8 For example, see Financial Times, '*Libor's long and wild ride is coming to an end*', 27 July 2017.

9 Some tenors of USD LIBOR may continue to be published until June 2023. This is to assist those with existing contracts referencing LIBOR and market participants are not expected to use LIBOR in new contracts after 2021.

10 See *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. 2005-04/AA227, Final Award dated 18 July 2014, paragraph 1679.

11 EURIBOR has been reformed since the manipulation of LIBOR came to light and is not being discontinued.

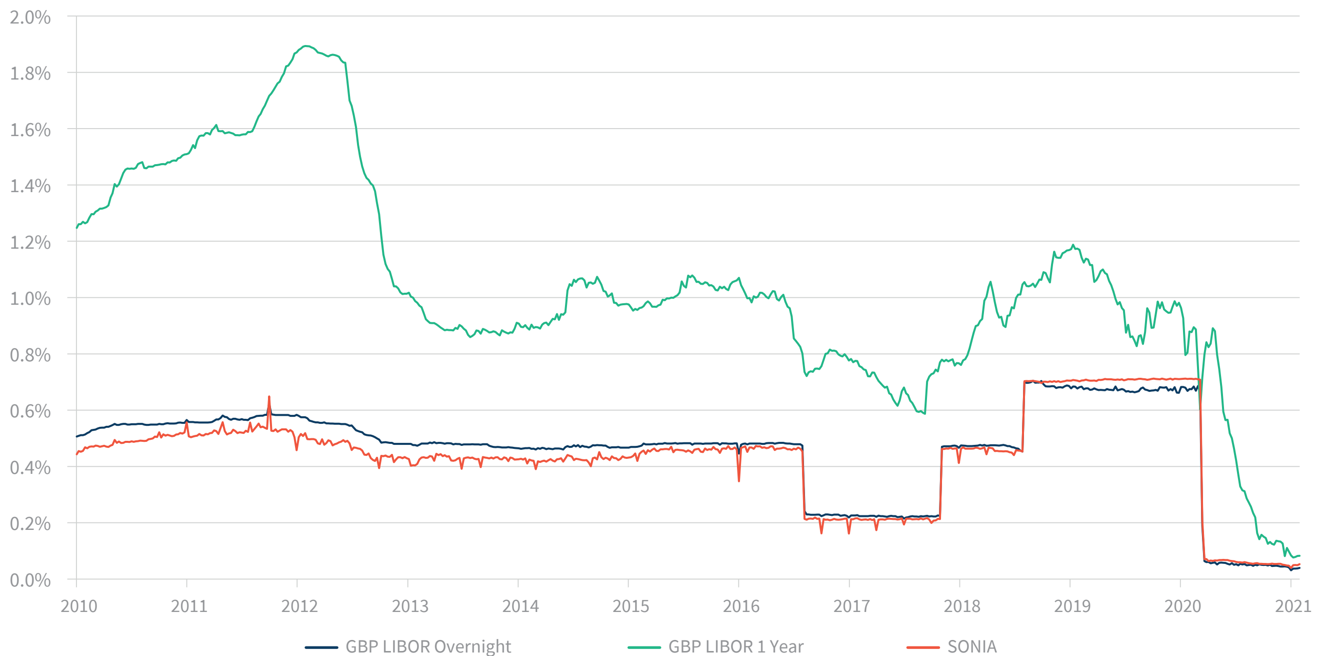
12 See *Inicia Zrt, Kintyre Kft and Magyar Farming Company Ltd v. Hungary*, ICSID Case No. ARB/17/27, Award dated 13 November 2019, paragraph 432.

13 Financial Conduct Authority, '*Transition from LIBOR*' (see https://www.fca.org.uk/markets/libor).

14 As indicated by the Tribunal's decision in *Magyar Farming v Hungary* (see above), EURIBOR may provide a suitable substitute for EUR-denominated LIBOR when calculating interest awards. EURIBOR does not have GBP- and USD-denominated variants.

15 There are other differences. For instance, SOFR is a secured borrowing rate (i.e. it reflects collateralised transactions) while LIBOR is an unsecured borrowing rate (like LIBOR, SONIA and €STR are unsecured rates).

SONIA AND OVERNIGHT AND ONE-YEAR GBP LIBOR, JANUARY 2010 TO FEBRUARY 2021



Source: Capital IQ and Bank of England.

As shown in the figure above, SONIA provides a reasonable approximation to overnight GBP LIBOR but differs significantly to longer-term GBP LIBORs, such as the one-year rate.

Following the discontinuation of LIBOR, it is very unlikely to be appropriate to simply switch from a 'GBP LIBOR + X%' approach to a 'SONIA + X%' approach (and similarly for USD LIBOR and SOFR) if the objective is to approximate a rate of maturity longer than overnight. If required, methodologies have been published which allow – in certain circumstances – for market participants to replace references to LIBOR with references to the new benchmark rates, adjusted for differences between LIBOR and that benchmark rate.[16] There are, however, other reference rates of longer maturity available including risk-free rates and measures of the borrowing costs of borrowers of various credit qualities.

Which reference rate is appropriate will depend on the purpose of interest, which is one of the topics that we consider in the following section.

The choice of interest rate for interest awards

What interest rates are awarded in practice?

There is no single approach that can be used to assess interest in all situations. As one practitioner explains:[17]

> *"… no uniform rule of law relating to interest has emerged from practice in transnational arbitration, in contrast to well developed rules regarding the determination of the standard of compensation for damages resulting from a breach of contract"*

International investment treaties often specify that interest should be awarded at a "*normal commercial rate*", "*appropriate market rate*" or "*commercially reasonable rate*", or similar.[18] However, a wide range of rates fit these descriptions.

16 As described above, LIBOR is used in a variety of contexts, including derivative contracts. In October 2020, the International Swaps and Derivatives Association (ISDA, the leading trade organisation and standard setter for the 'over-the-counter' derivatives market) published a protocol setting out 'fallback' adjustments for contracts linked to LIBOR. In effect, this protocol will see references to LIBOR in certain derivative contracts replaced with references to new fallback rates. Those fallback rates are based on the alternative benchmark rate (e.g. SONIA, in the case of GBP LIBOR), adjusted for differences in term and spread between the rates (e.g. between six-month GBP LIBOR and overnight SONIA). See ISDA, ISDA Launches IBOR Fallbacks Supplement and Protocol, 23 October 2020; and ISDA, Understanding IBOR Benchmark Fallbacks, 2020.

In addition, the FCA has consulted on whether 'synthetic' LIBORs may continue to be published. These would be calculated under a changed methodology, likely similar to the ISDA fallback methodology. The intention is that these 'synthetic' LIBORs will not be used in new contracts, but instead be used for legacy contracts where it is not practical to change to a new methodology. See FCA, LIBOR - are you ready for life without LIBOR from end-2021?, Speech by Edwin Schooling Latter, 26 January 2021.

These fallback rates and 'synthetic' LIBORs may be useful for practitioners to calculate interest in cases where interest has been awarded based on LIBOR but where payment is not expected for some time (e.g. due to an appeal).

Further information about how market participants are transitioning away from LIBOR (including the use of fallback rates) can be found in the article LIBOR: The Final Countdown produced by our colleagues in the Capital Markets Services team.

17 Matthew Secomb, *'Interest in International Arbitration'*, Oxford International Arbitration Series, 2019, paragraph 1.02.

18 Some bilateral investment treaties are more explicit (such as the Italy-Egypt BIT referred to in footnote 5) but others provide no guidance on interest. Quotations in the text are from the United Kingdom 2008 model BIT, France 2006 model BIT and Canada 2004 model BIT, respectively.

For instance, in 2020, the United Kingdom government issued bonds with a negative yield (i.e. a negative borrowing rate), while at a similar time Ford issued bonds with a yield of 8.5%.[19] Both rates can be considered 'commercial' in that they reflect the views of investors in the bond market.

Given the lack of an established approach for calculating interest and the limited guidance within international investment treaties, a wide variety of rates are seen in practice, including:

(1) **Statutory or contractual rates.** In some circumstances, the applicable law or contract may identify the interest rate to be applied.[20]

(2) **'Fair' or 'reasonable' rates.** Some awards refer to a "*fair*" or "*reasonable*" rate, often set at the discretion of the Tribunal with limited explanation.[21] Without further information it is not possible to say what factors a Tribunal has considered in reaching its conclusion.

(3) **'Coerced loan' approach.** This considers the respondent's cost of borrowing, on the basis that the claimant has effectively lent money to the respondent for the period over which it has been deprived of funds (i.e. between the date when damages are assessed and when they are paid).[22]

(4) **Claimant's 'borrowing rate'.** Awards of interest at the claimant's borrowing rate are sometimes justified on the basis that the claimant has (or may have) had higher borrowings as a result of not having access to the money claimed.[23] This approach may be implemented using reference rates such as LIBOR plus a premium which, as described above, is often considered to reflect the higher cost of borrowing for large non-financial corporations relative to banks.

(5) **Returns on alternative investments.** Some claimants claim for interest based on the returns that they could (or would) have earned if they had been able to invest the amount claimed. This approach often considers the returns on low-risk investments, such as government bonds or United States certificates of deposit,[24] but can also consider riskier investments (for instance, an investment in a specific project).[25] Some claimants claim for their weighted-average cost of capital ('WACC'), on the basis that this is the return that they would have sought on any funds available to them.[26]

What is the purpose of interest?

The appropriate interest rate will depend on the purpose of the award of interest. Three broad purposes are often discussed (and are not necessarily mutually exclusive):

(1) **Purpose 1: Compensation for the loss of use of money.** The most common rationale given for awarding interest is to compensate the claimant for the loss of use of money resulting from the breach. For instance, in *Vivendi v Argentina (I)*, the Tribunal considered that:[27]

> *"The object of an award of interest is to compensate the damage resulting from the fact that, during the period of non-payment by the debtor, the creditor is deprived of the use and disposition of that sum he was supposed to receive"*

(2) **Purpose 2: Restitution for unjust enrichment of the respondent.** Interest may be awarded to ensure the respondent has not profited as a result of compensation being delayed. In the *Sempra Metals* litigation, Lord Nicholls stated that:[28]

> *"The benefits transferred by Sempra to the Inland Revenue comprised, in short, (1) the amounts of tax paid to the Inland Revenue and, consequentially, (2) the opportunity for the Inland Revenue […] to use this money for the period of prematurity.*

19 Yields on three-year bonds issued in April and May 2020. See Financial Times, *'UK sells negative-yielding government bonds for first time'*, 20 May 2020; and Financial Times, *'Ford to pay nearly 10% on new debt to plug losses'*, 17 April 2020.

20 For example, in *Swisslion v. Macedonia*, the Tribunal awarded interest based on "*annual LIBOR*", in accordance with the Macedonian-Swiss BIT. See *Swisslion DOO Skopje v. Macedonia, former Yugoslav Republic of*, ICSID Case No. ARB/09/16, Award dated 6 July 2012, paragraph 358.

21 For example, in *Impregilo v Argentina*, the Tribunal awarded interest at a rate of 6%, considering this to be "*adequate and reasonable in the circumstances of this case*". See *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award dated 21 June 2011, paragraph 383.

22 For example, see *Cargill, Incorporated v. United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award dated 18 September 2009.

23 For example, see *Tidewater Investment SRL and Tidewater Caribe, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Award dated 13 March 2015.

24 For example, in *Siemens v Argentina*, the Tribunal awarded interest based on US six-month certificates of deposit as "*the rate of interest to be taken into account is not the rate associated with corporate borrowing but the interest rate the amount of compensation would have earned had it been paid after the expropriation*". See *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award dated 17 January 2007, paragraph 396.

25 For example, in *Alpha Projektholding v Ukraine*, the Tribunal awarded interest at 9.11%, equal to the risk-free rate plus a market risk premium. The Tribunal considered that "*this rate better reflects the opportunity cost associated with the Claimant's losses, adjusted for the risks of investing in Ukraine*". See *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No. ARB/07/16, Award dated 8 November 2010, paragraph 514.

26 For example, see *Vantage Deepwater Company and Vantage Deepwater Drilling, Inc. v. Petrobras America Inc., Petrobras Venezuela Investments & Services, BV and Petróleo Brasileiro S.A. (Petrobras Brazil)*, ICDR Case No. 01-15-0004-8503, Final Award dated 29 June 2018.

27 See *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentine Republic*, ICSID Case No. ARB/97/3, Award dated 20 August 2007, paragraph 9.2.3.

28 See *Sempra Metals Limited v. Her Majesty's Commissioners of Inland Revenue & Anor.* [2007] UKHL 34. We discuss the *Sempra Metals* decision and its implication for interest awards later in this article.

The Inland Revenue was enriched by the latter head in addition to the former. The payment of ACT was the equivalent of a massive interest free loan. Restitution, if it is to be complete, must encompass both heads. Restitution by the Revenue requires (1) repayment of the amounts of tax paid prematurely (this claim became spent once set off occurred) and (2) payment for having the use of the money for the period of prematurity."

(3) **Purpose 3: Promotion of efficiency.** A third reason for awarding interest is to encourage timely settlement of disputes by discouraging the respondent from seeking to delay resolution.[29] This purpose reflects that, if interest was not awarded (or if the rate awarded was too low), the respondent may not be incentivised to resolve the dispute.[30]

In this article we primarily consider Purpose 1: interest as compensation. In our experience, this is the purpose most often referred to by Tribunals when making an award of interest, although Tribunals adopt various interest rates to achieve this purpose. Purpose 2 – interest as restitution – is also referred to by Tribunals, although less frequently in our experience, and some Tribunals specifically reject calculations of interest on this basis.[31] While commentators refer to efficiency as a purpose of interest, we are not aware of any awards which have assessed an appropriate interest rate based solely on achieving this objective.

What interest rates should be awarded?

If the primary purpose of interest is to compensate for the loss of use of money, compensation can cover a broad range of consequences of being deprived of funds. In this article, we set out a potential economic framework for determining the appropriate interest rate, distinguishing between three approaches:[32]

(1) compensation that accounts only for the time value of money;

(2) compensation that reflects the risks to which the claimant has been exposed as a result of being owed money by the respondent; and

(3) compensation for the specific consequences of the claimant not having access to the money claimed. These consequences will depend on how the claimant would have used the money, for instance whether it would have repaid borrowings (so avoiding interest expense) or used the money to fund an investment.

Which of these three approaches is appropriate is often primarily a matter of law.

COMPENSATION FOR THE TIME VALUE OF MONEY

Under this approach the claimant should be compensated for the 'time value of money' – that it is preferable to receive a certain amount of money today rather than in the future. This requires the claimant to be awarded interest of at least the risk-free rate (where there is no or negligible chance of default by the borrower). In this context, widely used risk-free rates include the yields on bonds issued by the governments of large stable economies, such as the United States (for an award in USD) or Germany (for an award in EUR).[33]

One practical issue that may arise when awarding interest at the risk-free rate is that in some currencies the yield on instruments typically used to measure the risk-free rate is negative. As an example, yields on 10-year Danish government bonds denominated in kroner have been negative since early 2019. Tribunals may be uncomfortable awarding negative interest.

COMPENSATION FOR THE RISKS TO WHICH THE CLAIMANT HAS BEEN EXPOSED

An award of interest at the risk-free rate assumes that the claimant should not be compensated for any investment risks. However, it may be appropriate to award interest at a higher rate, if the claimant is entitled to compensation for certain risks.

Claimants face the risk that the respondent will default on its obligations under any award of damages (for instance because it does not have enough funds to cover the award).

29 For example, see Thierry J. Sénéchal & John Gotanda, *Interest As Damages*, Columbia Journal of Transnational Law, 2009, page 496.

30 Consider the case where a respondent can only pay an award of damages by raising debt from the financial markets at a high rate of interest. If the award of damages does not contain an interest component (or if the interest component is insufficient), it may be cheaper for the respondent to delay payment of the award as long as possible, rather than borrowing the funds and incurring interest.

31 For example, in *Tidewater v Venezuela*, the Tribunal rejected an approach which calculated interest based on the respondent's borrowing cost, finding that interest "*simply aims to compensate the claimant from being kept out of its money between the date on which it ought to have been compensated and the date of payment of an enforceable award*". See *Tidewater Investment SRL and Tidewater Caribe, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Award dated 13 March 2015, paragraph 205.

32 The application of this framework will depend on the factual and legal aspects of the case.

33 Not all government bonds provide investments that are risk-free or even close to being risk-free. For instance, local currency Argentinian government debt currently has a non-investment grade credit rating. Such bonds do not, therefore, provide a reference point for a risk-free rate to apply to an award in Argentinian pesos. There are ways in which a risk-free rate can be estimated in such a currency. One way is to adjust the risk-free rate in a currency for which lower risk government bonds are available (such as USD) for differences in inflation rates between the two currencies (here, USD and pesos). Another is to consider the pricing of financial products that protect against a default by the relevant government, and to deduct the cost of such a product from the yield on its debt.

Interest at the risk-free rate is generally insufficient to compensate for this default risk. This can be seen from the fact that most respondents can only borrow at rates higher than the risk-free rate, given their perceived creditworthiness. The Tribunal in *ConocoPhilips v Venezuela* explained that an award of interest at the risk-free rate would "*make it substantially attractive for* [the Respondent] *to borrow money from the investor at such rate*".[34]

Accordingly, some claimants claim interest at the respondent's cost of borrowing, which reflects the respondent's default risk. This approach is sometimes expressed as saying that the claimant has essentially been forced to make a loan to the respondent, and bears the respondent's credit risk between the date of breach and the date of award (and thereafter, if the respondent does not pay the award immediately). This situation is referred to as a 'coerced loan', made by the claimant to the respondent.

Tribunals have explicitly adopted the coerced loan approach in a relatively small number of publicly available awards. Examples include *Cargill v Mexico*, where the Tribunal considered that the claimant has "*effectively loaned this sum to Respondent for the duration of this dispute*",[35] and *Bear Creek v Peru*, where the Tribunal adopted an interest rate consistent with "*Peru's external cost of debt financing from private lenders*".[36]

One argument sometimes levied against the coerced loan approach is that in situations where the respondent pays the award, it is known not to have defaulted and hence it would not be appropriate to compensate the claimant for a risk that has not come to pass. Such logic is consistent with our experience that awards of interest tend to be assessed on an *ex post* basis (i.e. taking account of all information available at the current date rather than restricting analysis to the information set available at the date of the breach).[37] However, the premise of the coerced loan approach is that the claimant has still borne the risk, even if it has not materialised.[38]

34 See *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Award dated 8 March 2019, paragraphs 813 to 815.

35 See *Cargill, Incorporated v. United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award dated 18 September 2009, paragraph 544.

36 See *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award dated 30 November 2017, paragraphs 713 and 714.

37 An example of how awards of interest tend to be assessed on an *ex post* basis is that interest calculations tend to reflect the actual interest rates observed between the date of breach and date of award, rather than *ex ante* expectations of the appropriate rate as at the date of breach.

38 As an analogy, consider an insurer who has insured against a risk that ultimately does not materialise. The insurer will typically retain the insurance premium and not return it to the customer, because the insurer nevertheless bore the risk. In the context of an arbitration, the claimant has not borne the risk of default voluntarily as an insurer has.

Further, an award of interest at the respondent's cost of borrowing achieves another potential purpose of an award of interest: it avoids the respondent from profiting as a result of compensation being delayed.

COMPENSATION FOR THE SPECIFIC CONSEQUENCES OF THE DELAY IN COMPENSATION

When applying either of the two approaches above, it is not necessary to consider the characteristics of the claimant. An alternative approach is to consider how the claimant would have used the relevant funds. A claimant may have used these funds to:

(1) invest in low-risk assets to earn interest;

(2) repay debt or avoid taking on new debt, thereby reducing its interest expenses;

(3) invest in its own business or other projects; and/or

(4) pay dividends to shareholders or avoid raising additional equity finance. (In this case, it will be the shareholders who have suffered the loss of use of the money, rather than the company itself.)

Some commentators refer to a claim that addresses the specific way in which the claimant would have used the funds as being for 'interest as damages', rather than 'interest on damages', as this assessment is often performed by comparing the claimant's position in the actual and counterfactual positions since the date of harm.

Under English law, parties sometimes refer to the *Sempra Metals* litigation when discussing the awarding of interest as damages. In this case, Lord Nicholls stated that:[39]

> *"…an unparticularised and unproved claim simply for 'damages' will not suffice. General damages are not recoverable. The common law does not assume that delay in payment of a debt will of itself cause damage. Loss must be proved."*

And Lord Scott stated that:

> *"…interest losses caused by a breach of contract or by a tortious wrong should be held to be in principle recoverable, but subject to proof of loss, remoteness of damage rules, obligations to mitigate damage and any other relevant rules relating to the recovery of alleged losses."*

This decision specifically considered claims for compound interest. However, the decision indicates that more general claims for interest as damages can be made if the claimant can prove its actual losses. In other words, claims

39 See *Sempra Metals Limited v. Her Majesty's Commissioners of Inland Revenue & Anor.* [2007] UKHL 34.

for interest are subject to "*remoteness, mitigation and all the other general rules on damages*".[40]

The evidence required to prove the consequences of the delay in compensation may depend on the situation. For instance, a company with significant short- and long-term debt and a sophisticated treasury management function may not require much evidence to persuade a Tribunal that it could have used additional funds to reduce its existing debt. Potentially because of this, some Tribunals may award interest based on the claimant's cost of borrowing in the absence of any detailed discussion of how the claimant would have used the funds.[41]

In comparison, a claimant may require much more evidence to persuade a Tribunal that it would have invested additional funds in a project which it considers would have been highly profitable. Such a claimant may need to show why it could not fund the project in another way and how it can assess how profitable the project would have been.

CLAIMS FOR INTEREST BASED ON THE CLAIMANT'S WACC

One particular application of the 'specific consequences' approach is to award interest at the claimant's weighted-average cost of capital or 'WACC', which reflects the average cost of the sources of capital (i.e. debt and equity) used to finance a business.

It is relatively rare, in our experience, for Tribunals to award interest at the claimant's WACC. One Tribunal that did so was *Vantage v Petrobras*.[42]

A claim for interest at the WACC is – at least implicitly – a claim that the claimant could have reinvested the funds in its own business and expected to earn a return at least equal to its cost of capital. Those expected returns reflect the risk of investing in the claimant's business.

Before awarding interest at the claimant's WACC, the Tribunal should be mindful that the claimant did not have access to the money and so did not in fact invest it, so was not exposed to the risks associated with the relevant investment. In *GAI and Rurelec v Bolivia*, the Tribunal rejected the claimants' claim for interest at the WACC, stating that:[43]

> *"the WACC includes an ex ante allowance for forward-looking business risks which should not be applied ex post, since [the claimant] has not faced them"*

One potential counterargument to this position is that the claimant has not borne these risks because it has been denied the opportunity to do so. However, if the claimant has been denied investment opportunities, it would be open to it to quantify its resulting losses in the usual way. This might require it to:

(1) identify the specific opportunities foregone;

(2) demonstrate that it would otherwise have pursued these opportunities;

(3) explain why it could not borrow money to pursue these opportunities;

(4) explain whether its ability to pursue these opportunities has been lost entirely or simply delayed;

(5) show what cash flows have been lost as a result (which may differ to a return at the rate of the WACC).

The nature of such investigations is consistent with the extent of analysis and evidence that is often provided in support of the core damages to which interest is to be applied.

40 Harvey McGregor, *McGregor on Damages*, 18th Edition, paragraph 15-072.

41 In *Tidewater v Venezuela*, the claimant claimed interest at the respondent's cost of borrowing. The Tribunal instead awarded interest at "*the cost of borrowing the sum that the claimant ought to have received over the same period of time. Thus, the appropriate reference point is the cost of borrowing available to Claimants, not the amount that Respondent would have had to pay*". See *Tidewater Investment SRL and Tidewater Caribe, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Award dated 13 March 2015, paragraph 205.

42 In *Vantage v Petrobras*, the Tribunal awarded interest at a rate of 15.2%, compounded monthly. The Tribunal's reasoning is not set out in the award, beyond stating that "*the Tribunal has been persuaded by Dr. Jacobs' explanation of why the rate of 15.2% is the appropriate rate to be applied, in light of Vantage's cost of capital*". See *Vantage Deepwater Company and Vantage Deepwater Drilling, Inc. v. Petrobras America Inc., Petrobras Venezuela Investments & Services, BV and Petróleo Brasileiro S.A. (Petrobras Brazil)*, ICDR Case No. 01-15-0004-8503, Final Award dated 29 June 2018, paragraph 457D.

43 See *Guaracachi America, Inc. and Rurelec PLC v The Plurinational State of Bolivia*, UNCITRAL, PCA Case No. 2011-17, Award dated 31 January 2014, paragraph 615.

Conclusion

A wide variety of interest rates are awarded in practice. Tribunals often provide limited explanation of their choice of rate, relative to the amount of money at stake. Our review of publicly available English language ICSID awards indicates that around one-third of Tribunals use LIBOR as a reference rate, often adding a premium to this rate. LIBOR will begin to be discontinued from the end of 2021 but, as we have explained, other reference rates are available.

When identifying an appropriate interest rate, we consider that parties and Tribunals can distinguish between three approaches to an award of interest:

(1) compensation for the time value of money;

(2) compensation for the actual risks to which the claimant has been exposed; and

(3) compensation for the specific consequences for the claimant of being deprived of funds.

The appropriate approach must reflect the factual and legal circumstances of the case.

The relevant reference rate will depend on which of these approaches is chosen:

(1) the yields on bonds issued by the governments of large stable economies are often used to estimate risk-free rates which will compensate claimants for the time value of money;

(2) the cost of borrowing of a respondent can be estimated from its actual borrowing costs or a review of its creditworthiness (which will potentially be readily assessed if the respondent has a credit rating) and the cost of borrowing of other borrowers of a similar credit quality; and

(3) an award based on the specific consequences for the claimant will depend on what those circumstances are. We do not consider that an award of interest at the WACC will necessarily reflect those circumstances. Instead, the consequences of a delay in compensation may best be assessed by reference to the interest that the claimant could have earned on bank deposits, the interest that the claimant could have saved from borrowing less money, the return that the claimant would have earned on a specific opportunity that the claimant was prevent from pursuing, or some other rate.

If Tribunals wish to continue to rely on bank borrowing rates as a benchmark for awards of interest, then they may:

(1) pick an alternative ‘IBOR’ which is still published, such as EURIBOR as a substitute for EUR-denominated LIBOR; or

(2) use an overnight bank borrowing rate such as SONIA. It may be appropriate to add a premium to the chosen rate to reflect the relevant level of credit risk (whether 2% or otherwise). If an overnight rate is chosen, it may be appropriate to add a further premium to reflect the desired maturity.

The views expressed in this article are those of the author(s) and not necessarily the views of FTI Consulting, its management, its subsidiaries, its affiliates, or its other professionals.

TIM BATTRICK
Managing Director
+44 (0)20 3727 1044
tim.battrick@fticonsulting.com

TIM RICHARDS
Director
+44 (0)20 3727 1134
tim.richards@fticonsulting.com

FTI Consulting is an independent global business advisory firm dedicated to helping organisations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities.©2021 FTI Consulting, Inc. All rights reserved. **www.fticonsulting.com**.

FTI CONSULTING™