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## CAUGHT IN THE “CROSSFIRE”: QUANTUM CALCULATIONS IN INTERNATIONAL ARBITRATION

### *Introduction*

One of the primary challenges that arbitral tribunals face is the quantification of damages. In large, complex proceedings, arbitrators are inundated with voluminous expert reports by the parties, each promoting a different valuation of the same claim. Tribunals are left to their own devices when reviewing these reports in an attempt to assess the loss incurred by the alleging party.

In an endeavour to understand these underlying discrepancies and identify possible trends in the calculation of damages by tribunals, PricewaterhouseCoopers launched an investigation in 2015. As part of its study, PwC reviewed 95 publicly available arbitral awards and issued a report summarizing its findings in the Fall of 2015, updated in December 2017. The report (and subsequent update) identified trends concerning: (i) the disparity between claimants and respondents when quantifying a claim; (ii) the different methodologies adopted by tribunals when calculating damages; and (iii) tribunals’ approaches regarding interest.

### *1. Disparity in the quantification of damages*

PwC notes that, on average, a respondent recognized only 12-13% of the value of a claim as presented by a claimant. A lesser, yet nonetheless significant, disparity was presented in the value of claims ultimately determined by tribunals, which awarded, on average, 36% of the damages sought.

In seeking to explain the reasons for such discrepancies, PwC placed emphasis on two factors:

1. Different instructions given to the parties’ respective experts: The report comments that the party-appointed experts were instructed to base their calculations on different underlying assumptions, such as the valuation date or the facts underlying the claim.
2. Genuine differences in opinion between the experts: A second factor is differences in methodology used by quantum experts.

The inherent danger posed by the above “gap” is that tribunals will be discouraged from relying on the parties’ experts and will create an estimate of the quantum themselves in some other manner. PwC identified three possible solutions that tribunals could avail themselves to in addressing this issue.

1. Arguably the most straightforward answer would be for a tribunal to appoint a neutral third party expert to prepare its own valuation, yet this would inevitably raise the costs of the arbitration, and pose some significant procedural obstacles.
2. Alternatively, the tribunal could bifurcate the proceedings and schedule hearings dedicated exclusively to issues of quantum. This again would result in an additional cost to the parties.
3. The third option (and arguably the least expensive) would be to “hot tub” the parties’ experts. However, this method might favour experts who testify effectively even through their reports contain significant flaws.

## 2. Methodology for the calculation of damages

A second interesting observation in the report concerns the methodology implemented by tribunals in quantifying damages. The findings indicate that the “discounted cash flow” approach is the most popular method of calculating damages (45 cases), followed by the “historical/investment cost” approach (37 cases). Tribunals appear generally more comfortable with these methodologies because they are not unduly speculative (as opposed to forward looking, income approaches).

## 3. Interest

Finally, PwC noted that tribunals appear to be giving increased importance to the question of interest. The original 2015 publication stated that in 60% of the cases there was no explicit discussion of how interest was calculated. This, however, seems to have changed over the course of the last two years: in the 21 new cases reviewed, an increasing number of tribunals have devoted a greater portion of their awards to this specific issue.

With regard to the calculation of interest itself, PwC drew two conclusions:

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1. Taking inspiration from prior awards, many tribunals award interest in accordance with the LIBOR/EURIBOR rate with an uplift (often of 2%); and
2. Tribunals continue to prefer compound interest over simple interest, which reflects the economic reality that commercial borrowers pay compound interest on their loans.

Conclusion

This PwC report is based primarily on investment treaty disputes (commercial awards are generally confidential). However, the study remains instructive for private commercial parties in quantifying their claims against other commercial entities, as there is nothing to suggest that the trends identified by PwC are limited to investment treaty cases.