

Prejudgment interest – a mere afterthought?



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*Prejudgment interest may be a mere afterthought to many counsel and tribunals but it has significant economic impact on awards. **Tiago Duarte-Silva**, an economist at Charles River Associates in Boston, and **Jorge Mattamouros** of King & Spalding in Houston consider the treatment of prejudgment interest in 63 ICSID awards since 2000, which on average added 26% to the damages.*

In February 2016, GAR published an article on “How long is too long to wait for an award?”, in which **Jeffery Commission** of Vannin Capital provided a transparent record of how long is typically taken by tribunals at the various institutions that administer arbitrations. While lengthy arbitral proceedings are less desirable as a general matter, claimants are more harmed by the passage of time than respondents, assuming damages are assessed as of the date of harm and there is no prejudgment interest. Were it not for prejudgment interest, receiving an award monetarily equivalent to the harm suffered – too often, long after it occurred – would harm claimants and benefit respondents because the former would not be compensated for the deprivation of capital between the date of harm and the date of award.

Thus, in most circumstances, the passage of time between the date of harm and the date of the award is supposedly compensated by awarding prejudgment interest to the claimant. Tribunals’ discussion of prejudgment interest in arbitral awards, however, is more often than not a mere afterthought. Should it be granted more attention?

First, what is the relevance of prejudgment interest as a component of the total award amount? As discussed in detail below, prejudgment interest adds on average an extra quarter (or 25%) to the award amount. For the average case since 2000, prejudgment interest increased the total compensation to the claimant by US\$32 million.

Second, what is the impact of the choice of a specific prejudgment interest rate versus another? On average, prejudgment interest added approximately a tenth to the award when the rates were based on Treasury yields. In contrast, when the rates were based on LIBOR or on a fixed rate, prejudgment interest added approximately a third to the award. If,

hypothetically, all cases were awarded prejudgment interest at LIBOR plus 4% instead of Treasury yields, the overall award would, on average, be higher by 23% or almost US\$50 million.

If we are right on the significance of the impact of prejudgment interest rates on quantum, the third question to ask is what are the legal reasons tribunals consider and provide when setting prejudgment interest rates and how is the analysis conducted? Strikingly, the reasoning provided in most cases is very modest, if there is any at all, as is the underlying legal and policy analysis.

What we looked at

In this study, we focus on ICSID cases since 2000 which readily displayed award amounts in the UNCTAD Investment Dispute Settlement Navigator. We exclude settled and dismissed cases from our analysis of awards of prejudgment interest, as well as cases where the award was not publicly available. The starting point for our analysis is the set of 63 non-zero awards between January 2000 and March 2016.

In nine of the 63 awards, the specified prejudgment interest rate was linked to a benchmark (LIBOR or US Treasury yields) but did not specify the tenor; we assumed 12-month maturity in these instances. In 23 of the 63 decisions with an award of prejudgment interest, the rate's compounding frequency was not indicated; we assumed annual compounding frequency in these instances.

In 20 of the 63 cases, prejudgment interest was not based on LIBOR, US Treasury yields, or a fixed rate, or the award was not denominated in US dollars. Examples of other benchmark rates include Mexican Treasury yields, certificates of deposit rates, EURIBOR, and ROBOR. Also, two of these 20 cases either did not mention prejudgment interest or did not award it. For simplicity, we excluded these cases from the sample surveyed. After removing these 20 cases, we are left with 43 awards to analyse.

We obtained LIBOR rates from Bloomberg and Treasury rates from the US Federal Reserve. For simplicity, we assume prejudgment interest is always calculated from the date the case was registered, as a proxy for date of harm, to the award date, and at a rate as of the case's registration.

Awards and prejudgment interest rates

Of the 43 cases awarded since 2000 where award and prejudgment interest information was available, the prejudgment interest set by the tribunal in 16 of them was based on a fixed rate – that is, not linked to any benchmark rate such as LIBOR or Treasury yields. Of the remaining 27 cases, the prejudgment interest rate was based on LIBOR in 18, whereas it was based on Treasury yields in nine.

Table 1: Awards and categories of prejudgment interest rates

Prejudgment interest rate based on:	Number of cases	Award (excluding prejudgment interest)	
		Average	Median
LIBOR	18	US\$60.7 million	US\$29.2 million
Treasury yields	9	US\$109.9 million	US\$33.5 million
Fixed rates	16	US\$227.6 million	US\$17.2 million
All cases	43	US\$133.4 million	US\$19.4 million

As Table 1 shows, there are considerably large awards biasing averages upwards. While the median award was US\$19 million, the average was US\$133 million. Three quarters or 75% of the awards ranged between US\$6 million and US\$60 million. 90% of the awards were between US\$3 million and US\$131 million.

Prejudgment interest based on Treasury rates should lead to lower award amounts than those based on LIBOR because Treasury rates are lower than LIBOR. Moreover, when prejudgment interest is based on LIBOR, it typically includes an addition, as detailed in Chart 1. (For simplicity, one case with LIBOR + 1.12% is included with LIBOR + 1%).

Chart 1: Distribution of additions to LIBOR

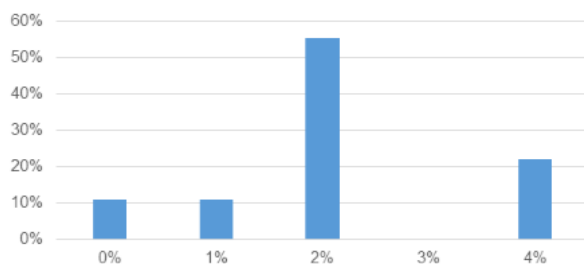
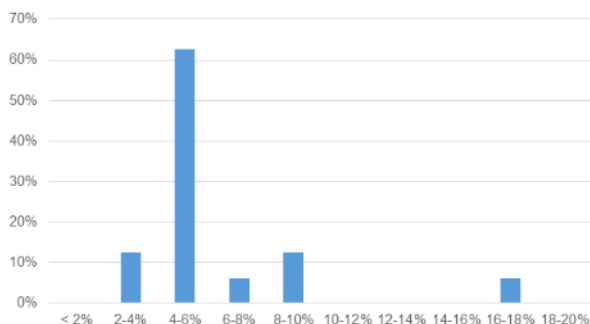


Chart 2 presents the distribution of fixed rates and illustrates that 6% seems to be a focal point in setting fixed rates of prejudgment interest.

Chart 2: Distribution of fixed rates



How much does prejudgment interest add to an award?

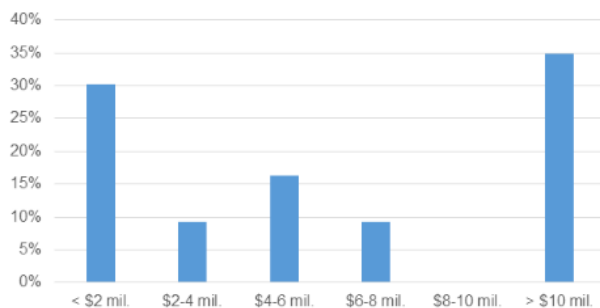
On average, prejudgment interest added approximately 26% to the award. The median increase was similar, at 23%. As expected, the average percentage increase was lower in cases where the prejudgment interest rate was based on Treasury yields: approximately 11%. Prejudgment interest added an average US\$59 million or almost a third to the award among the cases where its rate was fixed. Naturally, these increases could be lower in today's lower interest rate environment, but our analysis did not show a downward trend.

Table 2: Effect of prejudgment interest on total compensation to claimant (averages)

Prejudgment interest rate based on:	Increase in award due to prejudgment interest	Prejudgment interest
LIBOR	29%	US\$15.5 million
Treasury yields	11%	US\$8.6 million
Fixed rates	32%	US\$63.0 million
All cases	26%	US\$31.7 million

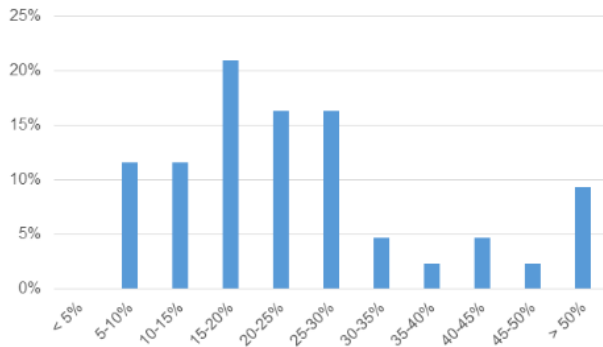
As Chart 3 shows, prejudgment interest increased the award by US\$10 million or more in approximately one-third of the cases (35% or 15 cases). For example, take *SGS v Paraguay* (ICSID ARB/07/29), where the tribunal awarded US\$39 million in February 2012. The award amount was \$39 million. The prejudgment interest rate was set at 1-month LIBOR + 1%, which added US\$10.4 million or 27% to the award. If the arbitral tribunal had set the rate to be based on 12-month Treasury yields, the prejudgment interest rate would have been 3.43%, adding US\$6.0 million or 15% to the award. So, the award including prejudgment interest would have been lower by US\$4.4 million if the tribunal had applied Treasury yields instead.

Chart 3: Distribution of prejudgment interest amounts



However, because this increase is dependent on the size of the award, in the next chart we present the distribution of the percentage increase in award due to prejudgment interest. Prior history shows that, in 25% of the cases (11 cases), the award increased by 29% or more due to prejudgment interest. Further, Chart 4 below shows that the award increased by 50% or more due to prejudgment interest in 10% of the cases (4 cases). For example, take *Victor Pey Casado v Chile* (ICSID ARB/98/2), which was awarded in May 2008. The prejudgment interest rate was set at 5%, which added \$6.4 million or 63% to the tribunal's award of US\$10.1 million.

Chart 4: Distribution of increases in total compensation to claimant due to prejudgment interest



How much does the choice of prejudgment interest rate affect an award?

The choice of prejudgment interest rate is intuitively relevant to the total compensation to the claimant, but here we go a step further by quantifying that relevance based on the available data. If LIBOR + 4% were used in all of the 43 cases examined, an average increase of close to US\$82 million or 44% would be added to the award. In contrast, if Treasury yield rates were used in all of the 43 cases examined, an average increase of US\$32 million or 16% would be added to the award.

This means that the choice between LIBOR + 4% and Treasury yield represents a difference of 28 percentage points in the award including prejudgment interest. If, hypothetically, all cases were awarded prejudgment interest at LIBOR plus 4% instead of Treasury yields, the overall award would, on average, be higher by 23% or almost US\$50 million.

Table 3: Effect of choice of prejudgment interest rate on total compensation to claimant (averages)

	Prejudgment interest rate	Increase in award due to prejudgment interest	Prejudgment interest
All cases	5.2%	26%	US\$31.7 million
If all cases' prejudgment interest rates were 12-month LIBOR + 4%	7.8%	44%	US\$81.7 million
If all cases' prejudgment interest rates were 1-year Treasury yield	3.3%	16%	US\$32.4 million
Difference		28 p.p.	US\$49.3 million

For example, take *Rumeli v Kazakhstan* (ICSID ARB/05/16), where the tribunal awarded US\$125 million to the claimant in July 2008. The prejudgment interest rate was set at 6-month LIBOR + 2%, which added US\$23.8 million or 19% to the award. If the arbitral tribunal had set the rate to be based on 12-month Treasury yields, the prejudgment interest rate would have been 3.85%, adding \$14.5 million or 12% to the award. Therefore, the award including prejudgment interest would have been lower by US\$9 million if the tribunal had applied Treasury yields instead.

As a final example, take the landmark case of *CMS v Argentina* (ICSID ARB/01/08), which was awarded in May 2005. The prejudgment interest rate was set at the Treasury yield of 2.51%, adding \$12 million or 9% to the tribunal's award of \$133 million. Had the tribunal set the prejudgment interest rate to be based on 12-month LIBOR + 4%, the interest rate applied would have been 7.68%, adding US\$42 million or 32% to the award. So, the award including prejudgment interest would have been higher by US\$30 million if the tribunal had applied LIBOR + 4% instead.

The legal reasons for the choice of prejudgment interest

The data presented above shows that prejudgment interest is, on average, a very substantial component of the damages awarded in investment cases. It would thus only be natural to assume that both counsel and tribunals would spend substantial time and pages discussing these issues in briefing, oral arguments, and awards. However, a review of the awards considered in this article suggests otherwise. First, the awards often lack a detailed and informed analysis of the legal reasons and policies supporting the award of prejudgment interest, in particular the rationale for awarding prejudgment interest in the case at hand and why that rationale is controlling. Second, even when a general discussion is present, the vast majority of the awards do not discuss how the specific interest rate applied fulfils the purported goal *vis-à-vis* the parties to the dispute or the underlying investment.

Among the awards included in our sample, less than 25% present a detailed analysis of the prejudgment interest rate applied, where tribunals chose a rate based on specific evidence and data pertaining to the parties, the investment, or the underlying dispute. These include implied or express agreement regarding the applicable interest rate, historical financial information of the parties and the project and market analysis during certain timeframes relevant for the computation of damages, among other factors.

In contrast, 23% set a prejudgment interest rate without *any* discussion of the rationale followed by the tribunal in awarding or setting it.

And while more than 50% of the awards contain a general discussion of the policies and legal reasons concerning various alternative prejudgment interest rates followed by a choice of one of those alternative rates and a conclusory statement by the tribunal, there is no detailed discussion of how the rate chosen is appropriate given the specific parties, investment project, or the dispute at hand.

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