

The logo for Global Legal Group (GLG) features the letters 'GLG' in a bold, sans-serif font. The 'G' and 'L' are white, while the 'G' at the end is orange. The logo is positioned in the top left corner of the page, which has a blue-tinted background image of a conference room with people seated around a table.

Global Legal Group

# The International Comparative Legal Guide to: International Arbitration 2011

## A practical cross-border insight into international arbitration work

Published by Global Legal Group, in association with CDR,  
with contributions from:

Abreu Advogados  
Aivar Pilv Law Office  
Anderson Mori & Tomotsune  
Borden Ladner Gervais LLP  
Boss & Young  
Bredin Prat  
Clayton Utz  
Clifford Chance CIS Limited  
CMS Cameron McKenna  
Cuatrecasas, Gonçalves Pereira  
De Brauw Blackstone Westbroek  
DLA Piper  
Dr. Colin Ong Legal Services  
Ebrahim Hosain  
Elvinger, Hoss & Prussen  
Frank Advokatbyrå AB  
FTI Consulting  
GESSEL Attorneys at law  
Habib Al Mulla & Co  
Hogan Lovells Lee & Lee  
Homburger  
JAMS  
Jiménez Cruz Peña  
K&L Gates LLP  
Kachwaha & Partners  
Karanovic & Nikolic  
Konrad & Justich  
Macleod Dixon  
Matheson Ormsby Prentice  
Motieka & Audzevicius  
Oscós Abogados  
PUNUKA Attorneys & Solicitors  
Ritter + Wohlwend Rechtsanwälte AG  
Shalakany Law Office  
Sherby & Co., Advs.  
Sidley Austin LLP  
Soewito Suhardiman Eddymurthy Kardono (SSEK)  
SKRINE  
Tilleke & Gibbins  
Tonucci & Partners  
Vouga & Olmedo Abogados  
Werksmans Attorneys  
Wilmer Cutler Pickering Hale and Dorr LLP

The logo for Commercial Dispute Resolution (CDR) features the letters 'CDR' in a bold, sans-serif font, with 'Commercial Dispute Resolution' written in a smaller font below it. The logo is enclosed in a rounded rectangular border.

# The International Comparative Legal Guide to: International Arbitration 2011

# GLG

Global Legal Group

## Contributing Editors

Steven Finizio and  
Wendy Miles, Wilmer  
Cutler Pickering Hale and  
Dorr LLP

## Account Managers

Monica Fuertes, Dror  
Levy, Florjan Osmani,  
Oliver Smith, Rory Smith,  
Toni Wyatt

## Marketing Manager

George Archer

## Sub Editors

Suzie Kidd  
Jodie Mablin

## Senior Editor

Penny Smale

## Managing Editor

Alan Falach

## Publisher

Richard Firth

## Published by

Global Legal Group Ltd.  
59 Tanner Street  
London SE1 3PL, UK  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
Email: info@glgroup.co.uk  
URL: www.glgroup.co.uk

## GLG Cover Design

F&F Studio Design

## GLG Cover Image Source

F&F Studio Design

## Printed by

Ashford Colour Press Ltd  
July 2011

Copyright © 2011  
Global Legal Group Ltd.  
All rights reserved  
No photocopying

ISBN 978-1-908070-04-3

ISSN 1741-4970



## Preface:

1 Preface by Gary Born, Head of International Arbitration Group, Wilmer Cutler Pickering Hale and Dorr LLP

## General Chapters:

1	<b>Meeting the Challenge: Efficiency and Flexibility in International Commercial Arbitration -</b> Kate Davies, Wilmer Cutler Pickering Hale and Dorr LLP	1
2	<b>The Search for Cost Effective and Efficient International Commercial Arbitration: There is a Solution -</b> Richard Chernick & Robert B. Davidson, JAMS	8
3	<b>Participation of Third Parties in International Arbitration: Thinking Outside the Box -</b> Marc S. Palay & Tanya Landon, Sidley Austin LLP	14
4	<b>The Recent Global Economic Environment: Impact on Damages and Valuation in International Arbitration -</b> Sharon Moore & Greig Taylor, FTI Consulting	19

## Asia Pacific:

5	<b>Overview</b>	Dr. Colin Ong Legal Services: Dr. Colin Ong	25
6	<b>Australia</b>	Clayton Utz: Doug Jones & Björn Gehle	33
7	<b>Brunei</b>	Dr. Colin Ong Legal Services: Dr. Colin Ong	43
8	<b>China</b>	Boss & Young: Xu Guojian & Mingjie Zhang	51
9	<b>Hong Kong</b>	Clayton Utz in association with Haley & Co: Glenn Haley & Patrick Daley	61
10	<b>India</b>	Kachwaha & Partners: Sumeet Kachwaha & Dharmendra Rautray	73
11	<b>Indonesia</b>	Soewito Suhardiman Eddymurthy Kardono (SSEK): Michael Carl & Dewi Savitri Reni	82
12	<b>Japan</b>	Anderson Mori & Tomotsune: Yoshimasa Furuta & Kiyoko Yagami	95
13	<b>Malaysia</b>	SKRINE: Ashok Kumar Mahadev Ranai & Lubna Sheikh Ghazali	103
14	<b>Pakistan</b>	Ebrahim Hosain: Zahid F. Ebrahim & Shabnam Noorali	114
15	<b>Singapore</b>	Hogan Lovells Lee & Lee: Paul Teo & Jonathan Leach	122
16	<b>Vietnam</b>	Tilleke & Gibbins: Michael Lee & Doan Ngoc Tran	130

## Central and Eastern Europe:

17	<b>Albania</b>	Tonucci & Partners: Neritan Kallfa & Majlinda Sulstarova	138
18	<b>Estonia</b>	Aivar Pilv Law Office: Pirkka-Marja Pöldvere & Ilmar-Erik Aavakivi	146
19	<b>Hungary</b>	CMS Cameron McKenna: Dr Zsolt Okányi LL.M. (Yale) & Dr Gergely László	153
20	<b>Lithuania</b>	Motieka & Audzevicius: Ramūnas Audzevičius & Mantas Juozaitis	162
21	<b>Macedonia</b>	Karanovic & Nikolic: Veton Ooku	170
22	<b>Poland</b>	GESSEL Attorneys at law: Dr. Beata Gessel-Kalinowska vel Kalisz & Małgorzata Badowska	177
23	<b>Romania</b>	CMS Cameron McKenna: Gabriel Sidere & Florin Dutu	185
24	<b>Russia</b>	Clifford Chance CIS Limited: Timur Aitkulov & Roman Khodykin	194

## Western Europe:

25	<b>Overview</b>	Bredin Prat: Tim Portwood	205
26	<b>Austria</b>	Konrad & Justich: Christian W. Konrad & Philipp A. Peters	209
27	<b>Belgium</b>	DLA Piper: Caroline Verbruggen & Jean-Michel Detry	217
28	<b>England &amp; Wales</b>	Wilmer Cutler Pickering Hale and Dorr LLP: Wendy Miles & Kate Davies	226
29	<b>France</b>	Bredin Prat: Tim Portwood	241
30	<b>Germany</b>	DLA Piper: Dr. Frank Roth & Dr. Daniel H. Sharma	250
31	<b>Ireland</b>	Matheson Ormsby Prentice: Nicola Dunleavy & Gearóid Carey	258
32	<b>Liechtenstein</b>	Ritter + Wohlwend Rechtsanwälte AG: Dr.iur. Ursula Wachter & Mag.iur. Samuel P. Ritter	267

Continued Overleaf →

Further copies of this book and others in the series can be ordered from the publisher. Please call +44 20 7367 0720

## Disclaimer

This publication is for general information purposes only. It does not purport to provide comprehensive full legal or other advice. Global Legal Group Ltd. and the contributors accept no responsibility for losses that may arise from reliance upon information contained in this publication. This publication is intended to give an indication of legal issues upon which you may need advice. Full legal advice should be taken from a qualified professional when dealing with specific situations.

# The International Comparative Legal Guide to: International Arbitration 2011

# GLG

Global Legal Group



33	<b>Luxembourg</b>	Elvinger, Hoss & Prussen: Yves Prussen & Marc Elvinger	274
34	<b>Netherlands</b>	De Brauw Blackstone Westbroek: Eelco Meerdink & Edward van Geuns	283
35	<b>Portugal</b>	Abreu Advogados: José Maria Corrêa de Sampaio & Pedro Sousa Uva	291
36	<b>Spain</b>	Cuatrecasas, Gonçalves Pereira: Cristian Conejero Roos & Iñigo Quintana Aguirre	302
37	<b>Sweden</b>	Frank Advokatbyrå AB: Hans Bagner & Kristoffer Persson	310
38	<b>Switzerland</b>	Homburger: Felix Dasser & Balz Gross	318

## Latin America:

39	<b>Overview</b>	DLA Piper: Pedro J. Martínez-Fraga & Harout Jack Samra	327
40	<b>Dominican Republic</b>	Jiménez Cruz Peña: Marcos Peña Rodríguez & Laura Medina Acosta	333
41	<b>Mexico</b>	Oscós Abogados: Dario U. Oscos C & Dario A. Oscos R	341
42	<b>Paraguay</b>	Vouga & Olmedo Abogados: Rodolfo Vouga Müller & Rodolfo G. Vouga Zuccolillo	350
43	<b>Venezuela</b>	Macleod Dixon: Ramón J. Alvins Santi & Pedro J. Saghy C.	357

## Middle East / Africa:

44	<b>Overview</b>	Habib Al Mulla & Co.: Gordon Blanke & Soraya Corm-Bakhos	368
45	<b>Egypt</b>	Shalakany Law Office: Khaled El Shalakany	372
46	<b>Israel</b>	Sherby & Co., Advs.: Eric S. Sherby & Sami Sabzerou	380
47	<b>Nigeria</b>	PUNUKA Attorneys & Solicitors: Anthony Idigbe & Omone Tiku	389
48	<b>South Africa</b>	Werksmans Attorneys: Des Williams	403
49	<b>UAE</b>	Habib Al Mulla & Co.: Gordon Blanke & Karim Nassif	413

## North America:

50	<b>Canada</b>	Borden Ladner Gervais LLP: Daniel Urbas & Robert J.C. Deane	422
51	<b>USA</b>	K&L Gates LLP: Peter J. Kalis & Roberta D. Anderson	430

# The Recent Global Economic Environment: Impact on Damages and Valuation in International Arbitration

FTI Consulting

Sharon Moore



Greig Taylor



The global economic turmoil that has permeated both developed and emerging markets has begun to abate in some areas, though the stage of recovery is still the subject of dispute among academics, analysts, and market participants. The stock and transaction market decline and related credit crunch beginning in 2007 rippled through developed and emerging markets. The contraction of private equity transactions also softened capital markets and certain volatility and fluctuations of markets rivaled that of any period since the Great Depression.

According to the U.S. Congressional Research Service, nearly all industrialised countries and many emerging and developing nations announced economic stimulus and/or financial sector rescue packages. Thus, the reaction to the global economic downturn has resulted in the easing of monetary policy, trillions of dollars of intervention and one of the most destructive impediments to economic recovery: uncertainty.

Particularly relevant in the capital and transaction markets is uncertainty about global and country-wide inflation and currency devaluation, as well as risks related to isolationism in the form of nationalisation and even the expropriation of foreign investments. These market-wide uncertainties translate into issues at the company level. For example, due to credit deficiencies, minimum order quantity conditions may be breached. Companies may no longer be able to secure necessary financing per contractual terms or agreed upon timetables. Contractual or budgeted capital and strategic projects may no longer be economically feasible, resulting in defaults on contracts and terminations.

Valuation and quantification of damages set against this global and microeconomic backdrop offer challenges, require particular expertise and care, and have a dramatic impact on valuers in at least two junctures. First, they affect the ability to quantify expectations of future economic performance of the markets, generally, and companies or enterprises, specifically. Secondly, the current and recent past global market has a critical impact on reliability of historical market pricing data, including discounts and premiums derived from that information, in the course of a valuation or damages analysis. The valuator must be careful not to inadvertently adopt a stressed market value rather than a fair market value.

In quantifying the economic loss to a participant in an international arbitration, be it a commercial or investor-state dispute, there are several different approaches that one usually considers. The expert then applies the most appropriate, given the underlying facts and circumstances of the specific matter at hand. The following sections highlight some of the areas of inquiry and analytics that may require unique attention in the course of valuation and damages analysis in the current and recent past global economic arena.

Before reviewing some of the unique challenges facing valuation and damages experts as a result of the recent global economic crisis, it may be helpful to briefly revisit some basic principles. We shall summarise briefly the difference between the “but for” and “actual” scenarios before explaining how these might be impacted by the crisis. We will then discuss the main approaches and methodologies for calculating damages, in particular the impact upon the fair market value standard, as well as the three main valuation approaches; the market, income and cost approaches.

## Implications in Approach to and Calculation of Damages

At the heart of the calculation of damages under most scenarios is the quantification of the harm suffered as the result of a wrongful act, be it a breach of contract or a lawful or unlawful expropriation. These are two of the most common examples subject to international arbitration.

A damage expert typically considers the actual and/or likely future results of operations of the enterprise and compares them to the “but for” cash flow scenario, absent the alleged harm (also known as the counter-factual). There may be more than one “but for” scenario to consider, depending upon the strategic vision of the enterprise and options available to it at the time of the alleged actions.

The focus is then on the actual/expected results versus the “but for” scenarios, with the difference being attributable to the alleged actions resulting in the derivation of an amount equivalent to the harm suffered. When considering future economic losses, the damages expert must consider appropriate risk factors and the resulting discount rate(s) in order to derive the present value of those future economic losses.

Assuming that the enterprise maintained and operated a robust forecasting process, the “but for” scenario could be based upon management’s prior budgets and forecasts and/or analyst projections. However, the tightening of credit and the economic environment have introduced new challenges when calculating the “but for” scenario(s).

It is incumbent on the expert to assess whether management’s forecast may not have fully anticipated the altered economic environment and, therefore, distort the potential future performance of the enterprise. In fact, the expert must often consider the extreme circumstance in which the enterprise was forecast to remain a going concern when such deterioration in the economic climate would suggest or has proven otherwise.

Therefore the damages remain the difference in the actual versus “but for” world. However, that “but for” world must take into

consideration reality at date of valuation versus the pre-crisis perspective. One needs to be able to adjust the original “but for” scenario and distinguish the difference between the original “but for” and actual “but for” to assess the economic impact and damages. As Irmgard Marboe states in her book, *Calculation of Compensation and Damages in International Investment Law*:

“The forecast must also take into account economic circumstances which would have influenced the company’s performance with and without the expropriation or the unlawful act. At a distance of some years, this is often a difficult task. The economic circumstances are constantly changing and it is important to distinguish between those factors which have to be included in the valuation and those which have to be excluded.” [See Endnote 1.]

The current economic turmoil has brought to the forefront a challenging issue in the quantification of economic damages; even though there may be an economic impact experienced by an enterprise, if it is the result of the economic crisis there may be no damage attributable to an opposing party in a dispute. For example, consider the scenario of a company alleging a breach of contract due to an erosion of sales as the result of the actions of a third party. If deteriorating sales is judged as primarily the result of the economy there may be no recoverable damages. Alternatively, if an enterprise requires an injection of fresh capital to maintain the business as a going concern and this is unattainable as a result of credit tightening, again there may be no recoverable damages to any harmed parties.

So how does one segregate the impact of the economic environment from the actual results of the enterprise? The actual results of operations may be impacted by two different factors: i) the alleged actions of the harming party; and ii) the economic volatility. The question then becomes whether it is fair to attribute the entire expected drop in performance to the alleged harmful acts when it is known that other factors impacted the performance of the enterprise. Thus, the parsing of the impact of these two factors defines the role of the damages expert. It is the experience and judgment of that expert that also ensures the proper treatment within the damages calculation. The diligent damages expert should not adjust for these considerations twice, thus cancelling out the intended adjustments or, conversely, double-counting them.

If permissible under the respective treaty or law, the consideration of the choice of damages theory may also change as a result of the recent economic experience. For example, in an investment treaty matter the actual cost of investment is a critical element. The historical underlying amounts invested in a project or enterprise will not change due to the deterioration in the economic climate, but their attractiveness as a head of claim may increase if future potential losses are adversely impacted by the considerations discussed above.

Coupled with this are important considerations concerning time, in particular the valuation date. The valuation date is usually either the date of breach or expropriation or the award date. Derived value of the underlying assets or the economic event in dispute may be materially impacted based on the date adopted, with a party seeking a higher valuation opting for the date where the asset value or economic loss is maximised. Thus, even if the determination of date is not under the discretion of the expert, the expert should understand the implications on the conclusions derived.

It is also recognised that the impacts of the economic conditions can be felt at different times around the world, e.g. the U.S. versus Global Cooperation Council (GCC) and Middle East and North Africa (MENA). Reports show that there are fundamental differences in the way the economic impact was felt in GCC and MENA economies versus the international market [see Endnote 2],

with GCC and MENA economies experiencing impacts up to six months after they began to be felt in the U.S.

Thus, the impact of the current and recent global economic events affects the damage analysis at every stage, from development of methodology to the resulting calculations and conclusions. This is especially true in the arena of fair market value determinations and calculations. The following section focuses specifically on the issues as they arise in this context.

### Impact on Enterprise and Asset Valuation - the Fair Market Value Standard

The determination of an opinion of value or a diminution in value is often the objective in an international arbitration. Enterprise and asset valuations, which often are the basis for damages, require particular expertise and rigorous analytics in periods of market fluctuation and uncertainty.

While there are several standards of value that may be adopted in valuation or damages calculation, the most often adopted and required is fair market value. Fair market value is the commonly-used basis for damages in investment treaty arbitrations, especially in expropriation cases, and is defined in the International Glossary of Business Valuation Terms as:

“the price, expressed in terms of cash equivalents, at which the property would change hands between a **hypothetical willing and able buyer** and hypothetical willing and able seller, acting at arm’s length in an **open and unrestricted market** when **neither is under the compulsion to buy or sell** and when both have **reasonable knowledge of the relevant facts**”. [Note: In Canada, the term “price” should be replaced with the term “highest price”] (emphasis added) [see Endnote 3].

While the definition and standard of fair market value has not changed, the recent economic climate exacerbates inherent challenges in the appropriate adoption and implementation of this standard. However, as discussed below, it is important to remember that marketplace characteristics do not change the appropriate standard of value; rather marketplace characteristics determine the way in which market data is developed, considered, and adopted in the course of a valuation analysis.

To this end, certain components of the fair market value standard that are particularly relevant in this economy will be examined here. The impact on the methods adopted to determine fair market value of a business enterprise will be discussed in more detail in subsequent sections.

#### Hypothetical Willing and Able Buyer [and Seller]

The starting point of determining fair market value is the assumption of hypothetical, willing transactional participants with the ability to act. The definition of fair market value requires the valuator to define the characteristics of the hypothetical participants contemplated. Having defined those characteristics, the analysis must incorporate and reflect market pricing behaviour consistent with those characteristics in the final quantum conclusion.

Therefore, it is important to differentiate between the hypothetical participants required by this standard of value and actual market participants transacting at the date of valuation. During periods of capital market and transactional volatility and fluctuation, the difference in the two can become more significant.

For instance, the hypothetical willing buyer is assumed to have economic motivation, ready access to capital and financial means to survive market downturns. The actual willing and able buyer

population may be pared due to factors such as restrictions on credit and greater risk aversion on the part of equity stakeholders.

In addition, the actual willing seller population may also be constricted. Selling shareholders may transact at prices lower than the fair market or intrinsic value of an enterprise or asset due to inability to withstand a low water point or actual needs for access to sales proceeds. If selling stakeholders perceive limited reinvestment opportunities for sales proceeds, they may be postponing their exit horizons.

In fact, from an equity stakeholder perspective, research suggests that the optimum holding period for securities has extended to a period closer to two decades versus one decade to allow sufficient time for recovery of downturns of the magnitude recently experienced. These delayed exit horizons could, therefore, siphon a certain amount of liquidity from the marketplace.

The implications of these trends are far-reaching. However from a valuation perspective, one of the most important implications is that market pricing data must be rigorously scrutinised to determine if it reflects pricing that is consistent with the economically motivated and able transactional participant assumed when implementing the Fair Market Value standard.

### Open and Unrestricted Market

The determination as to whether or not pricing data obtained from the marketplace reflects transaction pricing in an open and unrestricted market includes the consideration of several global and exchange-specific factors. Primarily this definitional component references liquid markets in which transactions are readily consummated in an organised marketplace. However, it may require consideration of several facts, including:

- government intervention that may introduce restrictions on the market; and
- rule of law considerations that may impact vibrancy of markets and investor confidence.

If the valuator determines that pricing data needs to be adjusted to reflect a hypothetical open and unrestricted marketplace, the magnitude and nature of those adjustments may be a source of dispute among valuers. Several possible analyses and adjustments may need to be highlighted. However, those issues deserve much more detailed treatment than this forum will allow.

### Neither is Under the Compulsion to Buy or Sell

In periods of economic turbulence, there is a greater likelihood that marketplace transactions reflect forced or unduly motivated transactions. Stakeholders may be forced to monetise assets or investments as a result of market-driven circumstances, including shortage of capital, creditor demands, covenant restrictions, liquidity needs, etc. The economic reality of compulsion may be market or country-wide.

This phenomenon should influence the valuator at various stages of the generally accepted valuation methods and will be discussed below. However, as with the hypothetical participant determination, the valuator must consider whether the market pricing data available reflects transaction prices among motivated participants, not forced participants. Transaction prices resulting from duress or compulsion rarely reflect the “intrinsic” value of an enterprise or asset that is sought under the fair market value standard.

### Reasonable Knowledge of the Relevant Facts

Most valuation opinions within the scope of international arbitration are undertaken as of a historical date. Therefore, one of the areas of opinion and testimony that is most subject to scrutiny by arbitrators and even other triers of fact is the concept of reasonable knowledge of the facts as of the date of valuation.

This fair market value mandate embodies the principle that an opinion of value as of a point in time should reflect the pricing settlement that would be derived with parity between the parties in terms of knowledge. It also imposes the concept that the derived value should be based on facts and circumstances that were known and knowable at the date of valuation and reasonable economic expectations based on that knowledge. In other words, the valuator must stand in the shoes of the willing buyer and seller and determine their opinion of value as if it had been derived as of the valuation date.

In periods during which market dynamics change dramatically, this particular aspect of valuation requires even more focused thought and consideration. That is certainly the case with valuations performed as of dates between 2007 and today. Particularly in expropriation and diminution disputes, for valuation dates in 2008 and 2009, the avoidance of hindsight may require more rigorous analysis and documentation.

Experts need to be thorough in the articulation of the effects of the economic climate on the wider economy, i.e. one must consider past experience and the impact of previous economic downturn and recovery on economic transactions. In this particular aspect of valuation, there is little substitution for seasoned judgment and experience in the valuation of assets and enterprises.

### Impact on Enterprise and Valuation - the Three Approaches to Value

Despite the unique economic circumstances wrought by events beginning in 2007, the three basic approaches to valuing any asset or enterprise remain sound and are defined in the International Glossary of Business Valuation Terms as follows:

**Market Approach:** “A general way of determining a value indication for a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.”

**Income Approach:** “A general way of determining a value indication for a business, business ownership interest, security, or intangible asset by using one or more methods that convert anticipated economic benefits into a present single amount.”

**Asset-Based (Cost) Approach:** “In the case of a business, business ownership interest, or security, the Asset Approach is a general way of determining a value indication by using one or more methods based on the value of the assets net of liabilities.”

Thus, the value of a business enterprise or one of its underlying securities is based on the net aggregate fair market value of the entity’s underlying assets. The technique entails a restatement of the balance sheet of the enterprise, substituting the fair market value of the assets and liabilities for their book values (or cost), including any off-balance-sheet assets or liabilities.

The three generally accepted valuation approaches described above are all subject to certain inherent, reasonable limitations. The reliability of the conclusions derived by each are dependent on the nature of the information available, the valuator or damages expert’s seasoned understanding of those limitations, and the

impact of market and economic conditions on them. Some of the inherent limitations are exacerbated by certain characteristics of the global economic environment. The appropriate consideration of these conditions is critical to an appropriate determination of methodologies to be adopted and the relative weightings placed on the resulting conclusions.

These three approaches to valuation will be discussed in more detail below, focusing on the limitations of the various methods within those approaches that require particular consideration as a result of the recent global economic environment.

### The Market Approach-Overview

The traditional market approach methods include:

- **Guideline Publicly Traded Company Method:** Derives value based on transaction prices for minority shares of a portfolio of publicly-traded companies, determined to be relevant to the valuation of the subject business enterprise.
- **Guideline Merged and Acquired Company Method:** Derives value based on transaction prices paid for controlling interests in a portfolio of private or publicly-traded companies, determined to be relevant to the valuation of the subject business enterprise.

### Market Approach Validity / Reliability in the Current Global Economic Environment

The validity of the market approach is generally based on the relationship between the portfolio of companies or assets with comparable levels of utility and their market values. The trends in capital markets will directly impact reliability and interpretation of underlying data. The impact of the recent past and current economic environment requires particular care at particular points in this analysis.

#### *Impact on Selection of Guideline Portfolio*

When markets are free of significant economic turbulence, transactions are generally consummated among interested but not compelled parties, and long- and short-term economic expectations are generally consistent within the marketplace; the market pricing multiples derived are generally accepted as relevant fair market value multiples. That is, the primary adjustments to those market-derived multiples are for variations between the guideline portfolio and the subject enterprise or assets, i.e., variations in size, stage of development, geographic concentration, customer diversity, etc. Thus, market multiples generally reflect fair market valuations.

However, during periods of market stress and dislocation, valuers must be more attuned to the differences between current market value and fair market value when comparability in terms of pricing volatility and fluctuation becomes more critical. Thus, the nature and duration of volatility and fluctuations in the industry or market sector must be considered. An examination of trading price fluctuations of individual portfolio companies may become more critical. While stock or transaction-pricing multiples are derived as of a specific point in time, the external market influences on those pricing multiples are particularly relevant.

There are several possible options for addressing this issue, including:

- review and analysis of published volatility indices for overall market and individual sectors;
- analysis of pricing multiples within the relevant industries to identify a period of time that “brackets” the market turbulence;
- perform an analysis to determine the correlation between

market turbulence and pricing multiples for individual portfolio companies; and

- propriety of “smoothing” of multiples should be considered.

In addition, the solvency and economic viability of the guideline portfolio may require greater scrutiny. A valuator may consider the individual portfolio company’s underlying access to capital particularly relevant. Portfolio companies with impending leverage events require specific attention. Examples of other considerations that may require greater diligence in this market setting are:

- variations in the pricing multiple trends of individual portfolio companies from sector to sector, generally;
- divestiture/acquisition history that may indicate a need to dispose of assets for liquidity or excess cash; and
- deviation from historical stock buy-back or dividend history.

The size of the guideline company or transaction portfolio may become more relevant. The aggregation of a larger portfolio may ease the impact of any acute pricing pressure reflected in the trading or transactional multiples of a particular portfolio company.

#### *Impact on the Development of Financial Fundamentals and Pricing Multiples*

Once the guideline portfolio has been selected, pricing fundamentals and multiples must be developed. The appropriate financial fundamentals, i.e., revenues, earnings, total assets, etc., may be directly influenced by the areas of market turbulence within a guideline sector or industry. For example, for a company whose sales have not been significantly affected by the recent market crisis and response, but whose profitability has been stressed, earnings fundamentals may be given less emphasis than revenues or asset-based fundamentals.

Financial fundamentals with greatest sensitivity to economic environment must be considered carefully. The use of average/median multiples that “straddle” periods of economic volatility should be considered to ensure a balanced valuation. The number of financial fundamentals adopted may also require closer scrutiny.

In addition, the emphasis on current, single period multiples may be inappropriate. Derivation of multiples for a 2, 3 or even a 5-year average or median financial fundamentals may better reflect a fair market value.

Finally, the ultimate selection and application of pricing multiples to subject enterprise/asset fundamentals is a reflection of the judgment and experience of the valuator. For example, in a period in which economic expectations are unfavourable, the valuator may select more conservative pricing multiples within the range of multiples derived. However, if the enterprise to be valued has weathered the financial crisis better than the guideline portfolio population it may be appropriate to apply a pricing multiple at the higher end of the range.

The most important issues are that the nature, duration and timing of global economic events must be considered and incorporated in the valuation and experts must be prepared to articulate and defend their interpretation within the analysis.

### The Income Approach - Overview

The traditional income approach methods include:

- **Discounted Cash Flow Method:** Derives value from projections of future benefit from the ownership of operations and projecting future investments required to maintain that level of benefits. The resulting available economic income (most often cash flow) is then discounted at a rate consistent with the inherent level of risk in the business.

- **Capitalised Future Economic Income Method:** Derives value from capitalisation of single period representative economic income for the subject company.

### Income Approach Validity / Reliability in the Current Global Economic Environment

Whether adopting the traditional discounted cash flow method or the economic income capitalisation method, the focus of the income approach is forward-looking and requires a discounting or capitalisation factor to reflect the time zero cash equivalent of expected future returns. In a period of economic turbulence and uncertainty, the projection of those returns may require more rigorous analysis and in-depth analysis of realistic expectations. Predictions of cash flow require greater diligence to avoid impairing the credibility of the valuator on grounds of speculation or hypothesis.

Among the issues that may impact the cash flow projections are:

- expected growth rates in revenues and profitability;
- historical or anticipated deferment of cash reinvestment in infrastructure and activities such as research and development and the resulting impact on the ability of an enterprise to maintain its market position; and
- reshuffling of competitive pressures and alliances as a result of the economic environment.

In addition, discount rate and cost of capital issues arise and require implementation that is theoretically sound and reflects market realities. For example, three particular issues that require rigorous and unique consideration in the current global environment include:

- Country risk considerations

There has been much discussion recently among professionals as to the theoretical propriety and necessity of such an adjustment. However, in practical consideration, several methodologies have been introduced to quantify those risks appropriately. Each of those methodologies requires specific attention to the unique market conditions that characterise this marketplace.

- Risk-free rate considerations

The development of a discount rate or capitalisation rate has at its foundation the assumption of a risk-free rate that is a building block for financial analysis. The turbulent economic climate has raised issues about existence of a risk-free rate. Treasury instruments of governments with strong, stable economies have, generally, been considered the standard of risk-free investments and a fundamental building block of risk analysis. A valuator must now apply special consideration to the components of the relevant risk factors in their valuation.

- Determination of the optimal capital structure

Another component in the derivation of discount rates has not received as much attention in literature, but has become an issue on which the finance function of leveraged enterprises are focused: the impact of the recent economic environment on the determination of the optimal capital structure. Companies are re-calibrating their debt to equity mix. Thus the valuator or damages expert must consider this issue in their analyses and adopt adequate techniques to address this issue.

The income approach methods are still the most widely used in most valuation projects. However, the current environment creates unique issues that require the expert to delve even more deeply into the underlying financial concepts and theories and challenge the "status quo" in certain basic steps within this approach.

### Asset-Based (Cost) Approach-Overview

The asset-based approach to the valuation of a business enterprise is misunderstood by many experts and consequently its powerful methodology may be overlooked. Using this methodology, the value of an enterprise is derived as the combined fair market value of the underlying assets. In the quest for shareholder value, the fair market value of the enterprise liabilities must be deducted. However, the total enterprise value is the addition of the fair market value of the following main balance sheet components:

Working Capital + Long Term Tangible Assets + Intangible Assets.

In this method, each individual class of assets must be identified, valued and the economic and functional obsolescence of each must be quantified.

### The Asset Approach Validity / Reliability in the Current Global Economic Environment

It is important to realise that the cost or asset approach does not refer to the historical cost of classes of assets. Rather, the term as adopted in this approach refers to the current market cost to replace the functional utility of each class of assets. Thus, the values are current, fair market values and the cost terminology is simply a description of the theoretical cost to replace the asset base that creates the underlying value of the enterprise. This method is especially relevant and compelling in the context of international arbitration as speculation and questionable hypothetical economic expectations generate reasonable scepticism by arbitrators.

One of the reasons this methodology may often be overlooked by experts is that the adoption requires a detailed understanding and ability to value all of the underlying assets and liabilities of an enterprise. Some of these include complex assets such as intellectual property, trademarks and trade names, loan portfolios, customer relationships, patents and patented technology, capital-intensive infrastructure, land, pension obligations, trained and assembled workforces, software and other technical assets. In addition, this methodology requires a sophisticated understanding of the economic contribution of these assets and their required economic return.

While it is theoretically true that the intrinsic value of an enterprise is the present value of the future economic benefits, it is equally true that determining that stream of net economic income may be enhanced by the extent to which the assets that produce that income are identified, assessed and valued. Thus, the adoption of this methodology requires understanding and experience in the valuation of specific asset and liability classes, including off balance sheet assets and liabilities.

Several characteristics of this methodology make it particularly relevant in the uncertainty created by recent global economic events. First, it is specific to the subject enterprise. It will be difficult to find two businesses, even in the same industry and geographic market, whose aggregation of assets is identical. Thus, in a period when arbitrators are particularly focused on the avoidance of speculation and inappropriate hypothesis, this methodology tends to be company-specific.

Second, it gives both the valuator and the arbitrator a microscopic view of the enterprise. This provides a valuable perspective in assessing the reliability of conclusions derived from other methodologies.

Third, this methodology recognises that various asset classes may be affected differently as a result of the global economic environment. For example, the impact on the capital-intense assets of a company may be significantly different from the impact on an

income-generating asset such as a trademark.

Finally, it allows the valuator to reconcile the overall cost of capital derived for adoption in an income approach to the costs of capital for individual asset classes as mutually supporting evidence that the cost of capital assumptions are appropriate. This may be particularly relevant when discount rates and rates of return fall outside normal, historical rates.

## Summary

In conclusion, consideration of the global economic environment means that valuation and the quantification of damages is likely to require greater reliance on seasoned judgment and experience in damages, generally, and valuation, specifically. The uncertainties inherent in such an environment suggest that further analysis could be required to explain and justify damages estimation and valuation conclusions. The issues raised now will be relevant for many years



### Sharon Moore

FTI Consulting  
1101 K Street, NW, Suite B-100  
Washington, DC 20005  
USA

Tel: +1 202 312 9120  
Fax: +1 202 312 9101  
Email: [Sharon.MooreBettius@fticonsulting.com](mailto:Sharon.MooreBettius@fticonsulting.com)  
URL: [www.fticonsulting.com](http://www.fticonsulting.com)

Sharon Moore is a Senior Managing Director at FTI Consulting and serves as the firm's International Arbitration point of contact in Washington, DC. Ms. Moore has also served as the firm's National Valuation Product Champion and has led regional valuation practices for both Deloitte & Touche and Arthur Andersen. Sharon is a Certified Public Accountant (CPA), an Accredited Senior Appraiser (ASA), Certified in Financial Forensics (CFF), and designated a Member of the Royal Institution of Chartered Surveyors (MRICS). In addition to testimony in international arbitration and disputed matters, she has testified as an expert on valuation and economic damages since 1987 in US Federal court, numerous state courts, US Tax Court, US Bankruptcy Court, and US domestic arbitration and mediation.

She serves on the Board of Governors of the American Society of Appraisers, an international appraisal organisation, representing her US region and the European continent, Russia, the Middle East, Africa, Australia, New Zealand, and India. Sharon also served on the founding committee for the International Institute of Business Valuators (IIBV), the international umbrella association working to advance the business valuation profession globally. She has been a contributing author in both texts and articles in valuation and damages for over 20 years.

to come given the time lag before arbitrations are filed, and the fact that proceedings on the quantification of damages tend to occur later in the process, further removed from the date of valuation or damage quantification. Keeping a contemporaneous record of current circumstances to be used for future reference may be beneficial in assisting experts, especially in the markets and sectors which are experiencing the highest volatility.

## Endnotes

- 1 Marboe, Irmgard, *Calculation of Compensation and Damages in International Investment Law* (Oxford: Oxford University Press, 2009) 227.
- 2 Global Investment House "Strategy – October 2008", page 9, table 5.
- 3 International Glossary of Business Valuation Terms.



### Greig Taylor

FTI Consulting  
3 Times Square, 9th Floor  
New York, NY 10036  
USA

Tel: +1 212 651 7150  
Fax: +1 212 841 9350  
Email: [Greig.Taylor@fticonsulting.com](mailto:Greig.Taylor@fticonsulting.com)  
URL: [www.fticonsulting.com](http://www.fticonsulting.com)

Greig Taylor is a managing director in FTI Consulting's Forensic and Litigation Consulting practice, based in New York. He has undertaken forensic accounting work around the globe including the UK, continental Europe, MENA, US and Central America. Greig's experience includes litigation consulting involving forensic accounting and financial investigations under different accountancy standards, buy-sell disputes, large-scale international acquisitions, bankruptcy issues, as well as assistance in domestic and international arbitration proceedings and the provision of expert testimony.

Greig has worked on numerous international arbitration matters for both claimants and respondents, under various institutions including ICC, ICSID, DIAC, SCC and the Zurich Chamber of Commerce.

Greig is a UK chartered accountant and member of the ICAEW. Greig is also a regional coordinating committee member of the ICC Young Arbitrators Forum North America Chapter, as well as a contributing author to the CPR International Committee on Arbitration's Protocol on Determination of Damages in Arbitration.



FTI's International Arbitration team works with a global client base across all industries from FTI's offices around the world, including London, Paris, Geneva, New York, Washington, DC, Houston, and Toronto. Our International Arbitration experts have testified in treaty and commercial arbitrations before panels constituted by international arbitration bodies including the ICC, the LCIA, the SCC, the ICDR, ICSID (including NAFTA and ECT disputes), the Iran-US Claims Tribunal, as well as under UNCITRAL rules and *ad hoc* arbitrations, and before domestic courts and tribunals.

### About FTI Consulting

FTI Consulting, Inc. is a global business advisory firm dedicated to helping organisations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 3,800 professionals located in most major business centres in the world, we work closely with clients every day to anticipate, illuminate, and overcome complex business challenges. Our broad range of services brings a depth of knowledge and experience that few organisations are able to match. More information can be found at [www.fticonsulting.com](http://www.fticonsulting.com).

# The International Comparative Legal Guide to: International Arbitration 2011

## Other titles in the ICLG series include:

- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Commodities and Trade Law
- Competition Litigation
- Corporate Governance
- Corporate Recovery and Insolvency
- Corporate Tax
- Dominance
- Employment & Labour Law
- Enforcement of Competition Law
- Environment & Climate Change Law
- Gas Regulation
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Patents
- PFI / PPP Projects
- Pharmaceutical Advertising
- Private Client Law
- Product Liability
- Public Procurement
- Real Estate
- Securitisation
- Telecommunication Laws and Regulations
- Trademarks

To order a copy of a publication, please contact:

Global Legal Group  
59 Tanner Street  
London SE1 3PL  
United Kingdom  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
Email: [sales@glgroup.co.uk](mailto:sales@glgroup.co.uk)