International arbitration damages study

Interest-ing times: trends and challenges in awarding interest in international arbitration

December 2024

We analysed 181 tribunal awards over a 30-year period to identify the key themes in damages awarded.[1] In this article, we delve deeper into the last issue on a tribunal's agenda – interest.

Introduction

It has been noted in a 2015 GAR article that interest is 'extremely important' from an economic perspective, but 'tribunals often give very little consideration' to the issue of interest.[2] This is certainly true of our population of awards: whilst pre-award interest forms 23%[3] of the value of the award (on average), only 3% of pages are devoted to it. The absolute amount of interest awarded averaged around $173 million, with the largest amount of interest awarded amounting to $12.8 billion.[4] In several cases, the amount of interest awarded exceeded the amount of damages to which it was added.[5]

The GAR article also points to (explicitly noted and implicit in comments) considerable differences in approaches to interest, both pleaded and awarded. Our research confirms this. This article explores and identifies some of the reasons for these differences and asks, given the varied nature of the cases, should we expect the treatment of interest to be the same in each case?[6]

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[1] Awards cover the period from 1990 to 2022. Our original article can be found at https://www.pwc.co.uk/forensic-services/assets/international-arbitration-damages-study.pdf.
[2] 'An unexpected interest in interest', Clemmie Spalton, 12 May 2015.
[3] This is a conservative percentage as in most cases our calculation of interest assumes the amount owing is paid the day after the date of the award, that is, we have not quantified or included the value of post-award interest.
[4] In some awards, no interest was awarded due to the application of negative interest rates.
[5] For example, see Mohamed Abdel Raouf Bahgat v the Arab Republic of Egypt; Ioannis Kardassopoulos and Ron Fuchs v Republic of Georgia; Chevron Corporation (USA) and Texaco Petroleum Company (USA) v Republic of Ecuador; Compañia del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica; or Duke Energy Electroquil Partners & Electroquil S.A. v Republic of Ecuador.
[6] This article explores the approaches taken and does not comment on whether the theory behind the approaches is sound.

On what issues do tribunals agree?

Compound v simple interest

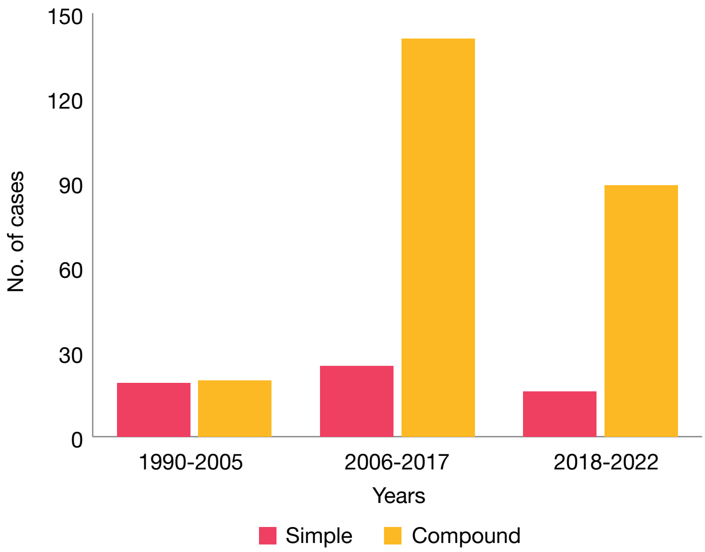
A common area of agreement between tribunals[7] is that full reparation is generally expected to include an award of interest.[8] Tribunals increasingly also now agree on the issue of compounding. The graph shows that, for our sample of cases, before 2005 the split of cases awarding simple versus compound interest was 49:51[9], but since then the split has moved to 15:85.[10]

The Compañia Del Desarrollo De Santa Elena SA v Republic of Costa Rica award, published in February 2000, is often cited by tribunals to explain that the use of compounding is not punitive in nature, but rather reflects the economic reality of investment – that of an investment opportunity being denied to the claimant by the respondent.[11] Roll forward 20 years, and this concept has prevailed and has been built upon by tribunals. For example, in PV Investors v the Kingdom of Spain (published in February 2020), it is the tribunal's view that interest should be compounded because if the claimants had not been deprived of the funds, they could have invested them and would have earned compound interest. Similarly, if as a result of the deprivation they had to borrow money, they would have paid compound interest on the debt.

Citing various reasons, approximately 19%[12] of the tribunals in our population viewed simple interest as the correct approach.

In cases where simple interest is awarded, it is often based on legal, statutory or contractual rates. In one case, the tribunal found that losses based on 'abstract' future profits should only attract simple interest whilst actual cash losses, such as incremental costs incurred, would, in that tribunal's mind, justify compound interest.[13] In Strabag SE v Libya, the tribunal concluded that, although 'compound interest is a feature of contemporary commercial and economic life', given the unusual circumstances of the case where respondent 'has been subject to a protracted period of force majeure… simple and not compound interest provides a more appropriate measure of compensation'.[14]

Compound v simple interest



In the Bank Melli Iran and Bank Saderat Iran v the Kingdom of Bahrain case, the tribunal awarded simple interest simply because the parties and their experts had not indicated at what frequency it would be appropriate to compound interest nor addressed whether interest should be compounded at all.

[7] However, entitlement to interest (pre-award, post-award or both) was mentioned as an area of disagreement between parties in approximately 20% of cases for which areas of disagreement were specified.
[8] For example, see paragraph 183 of SGS Société Générale de Surveillance SA v Republic of Paraguay, ICSID Case No ARB/07/29.
[9] This includes both pre-award and post-award interest.
[10] The same split was identified for both the period from 2006 to 2017 and for the last five years, i.e. the period from 2018 to 2022.
[11] See paragraph 104, Compañia Del Desarrollo De Santa Elena SA v Republic of Costa Rica.
[12] The percentage is similar for both pre-award and post-award interest, mostly because for the majority of cases in our sample, the same interest rate and methodology was applied pre-award and post-award.
[13] Československá obchodní banka, a.s. v Slovak Republic, ICSID Case No. ARB/97/4.
[14] ICSID Case No. ARB(AF)/15/1.

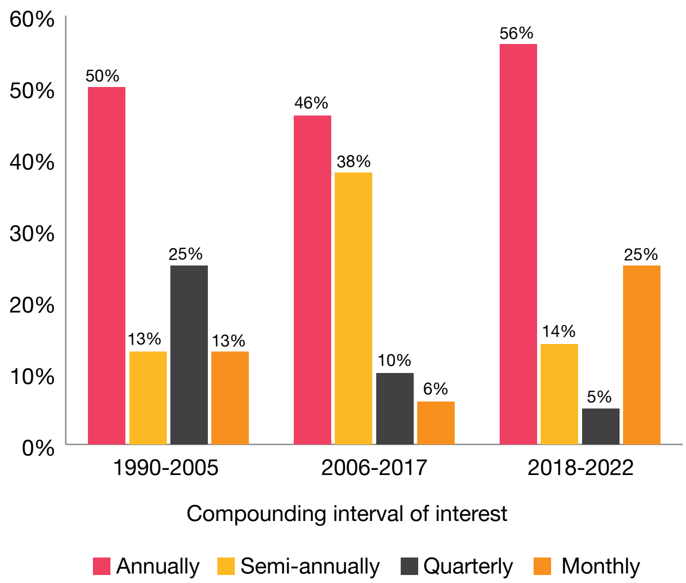
Compounding interval

We established that in the majority of the cases in our sample tribunals awarded compound interest, but at what intervals was interest compounded? Our research indicates a clear preference for annual compounding, which accounts for almost half of all cases, followed by semi-annual compounding, used in approximately a quarter of awards.

Compounding interval of interest	Percentage of total
Annually	47%
Semi-annually	26%
Quarterly	8%
Monthly	12%
Unclear	7%

The graph below shows that annual compounding has consistently been the most prevalent choice over time, most recently in 56% of cases. Compounding semi-annually was at its most popular during 2006 to 2017, being used in 38% of cases (compared to 46% compounding annually). Where quarterly compounding has seen a decline in use over time, monthly compounding has become more popular over time, accounting for 25% of cases from 2018 to 2022. It is not clear from the awards what factors are driving these trends, but one might guess that annual compounding is a relatively simpler methodology and produces a relatively lower amount of interest, whereas monthly compounding reflects the economic reality of monthly debt repayment schedules.

Compounding interval of interest



In several awards in our sample, we observed a mismatch between the compounding intervals and the interest rates applied. For example, in Perenco Ecuador Limited v Republic of Ecuador, the tribunal chose three-month LIBOR, yet applied these rates in conjunction with annual compounding.[15] This may be problematic because interest rates are computed to reflect the cost of borrowing over a specific period[16] and so in using a compounding period that does not match the interest rate, the awarded interest may not appropriately compensate the claimant.

[15] Other examples from the last five years include: LSF-KEB Holdings SCA et al v Republic of Korea; Grenada Private Power Limited and WRB Enterprises, Inc. v Grenada; Vale S.A. v BSG Resources Limited.

[16] For example, three-month LIBOR assumes a borrowing period of three months.

Differences in approach

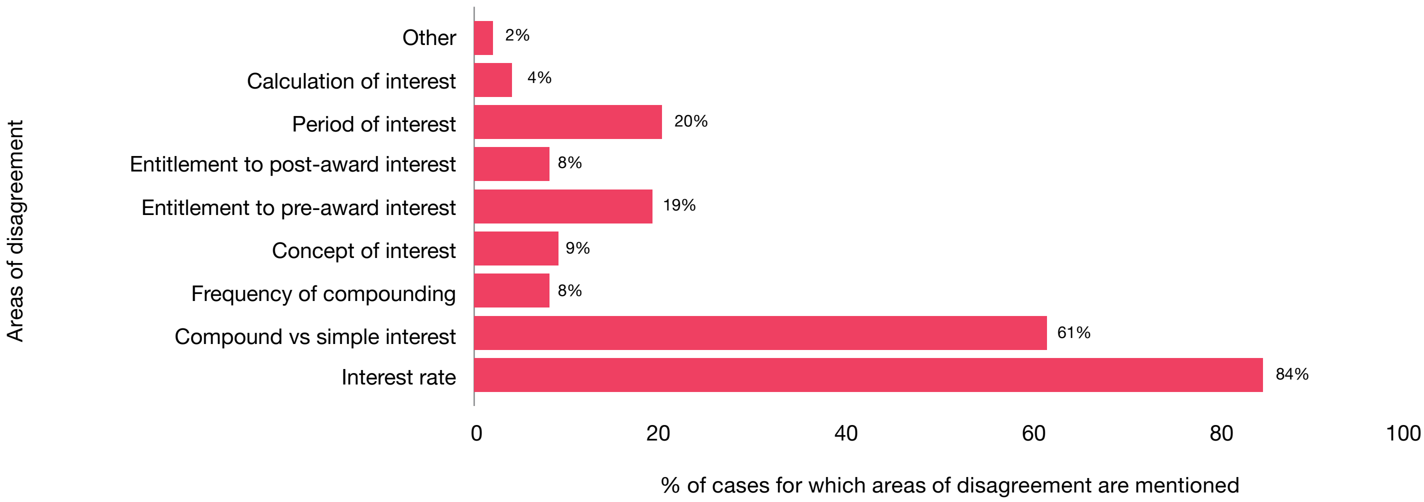
There was less consistency in approach in other areas: what the concept of interest represents, the appropriate rate to apply, whether interest should be linked to the currency of award, the impact on interest of the length of the period between breach and award, and the application of pre-award and post-award interest.

We explore the reasons for these differences in approach below and explain the different rates and approaches adopted by tribunals.

Overview of differences

The chart below sets out the main areas of differences between the parties when it comes to claiming interest.

Areas of disagreement between parties



Nature of the case

The individual circumstances of the case will (and potentially should) drive the calculation of interest, including interest rate and interest calculation decisions. For example, a case regarding unpaid invoices will likely attract a different interest rate and methodology to that of an illegal expropriation. This is an important factor and is likely to explain some of the differences in approach described below.

Theoretical concepts

In order to assess the correct interest approach and rate that will appropriately compensate the claimant, tribunals must first consider what it is they are seeking to compensate for. Articulating the concept of interest is key to quantifying the applicable interest rate.

Of the cases examined where interest was awarded, for approximately two thirds of awards it was possible to determine what the payment of interest represents conceptually. Where the award is silent on the conceptual approach, it is difficult for the reader to understand the applicability of the interest rate chosen.

The following table sets out the concepts attached to interest[17] by the tribunals in our sample:

Concept of interest	Percentage of total
Unclear	33%
Return on investment rate	22%
Cost of borrowing rate	27%
Contractual	9%
Legal	8%
Multiple	1%

[17] This includes both pre-award and post-award interest.

Measurement of rate

As stated previously, the measurement of the rate will flow from the nature of the case and the theory of interest applied. Many tribunals also use their discretion to select a rate. In our sample population, there is much variety in the interest rates chosen by tribunals.

Overall, 41%[18] of the cases in our sample applied a cost of borrowing rate (an interbank rate or a cost of debt rate), 32% of cases a return on investment rate (an interbank rate, a risk-free rate or bank deposit rate, 12% was based on legal rates and 14% on contractual rates.

Our analysis shows that although tribunals applied a cost of borrowing rate more frequently, they talked more about return on investment rates. But what do these rates represent and what rates are tribunals applying?

a. Return on investment

Awarding interest at a return on investment rate inherently assumes that, if the respondent had not deprived the claimant of the relevant sum, the claimant would have invested it to generate some sort of return. How did tribunals quantify this return?

Risk-free rate

Calculating interest by reference to a risk-free rate implies that the claimant would have invested the sum in risk-free instruments such as US Treasury securities, which were the most commonly referenced risk-free rates in our sample.[19] This approach offers some compensation to a claimant for the time value of money, but at the relatively low rate of return that you would expect from making a risk-free investment.

When awarding risk-free rates, it was common for tribunals to stress that rates should be 'conservative' or 'prudent', although we have not seen an explanation as to why this should be the case. In one example, the Bilateral Investment Treaty (BIT) in question allowed for interest at a 'commercially reasonable rate', which the tribunal felt could be represented by a risk-free rate.[20]

Interbank rate

Many tribunals quantified interest using an interbank rate, typically the US dollar LIBOR rate. Recently, we observed an increased use of EURIBOR.[21]

LIBOR is the return that banks in London earn when they lend money to each other for periods ranging from overnight to one year. EURIBOR is a similar reference rate used by Eurozone banks. Both of these rates were cited by tribunals as representing both a return on investment and a cost of borrowing rate. Often, an interbank rate was awarded without reference to the theoretical concept being applied.

Tribunals will often then apply an uplift to the interbank rate to give, for example, LIBOR +2%. Tribunals often appear to place a degree of reliance on jurisprudence and on their own discretion when selecting an appropriate rate, as opposed to specific evidence to justify the percentage point uplift chosen. LIBOR + 2% was by far the most frequently uplifted interbank rate awarded. Several tribunals noted in this respect that '2% is a reasonable margin, which reflects the surcharge which an average borrower would have to pay for obtaining financing based on LIBOR'.[22]

EURIBOR is naturally more appropriate to use in cases where the currency is euros.[23] However, the reason for its recent increase in popularity may have been tribunals' expectation for the cessation in LIBOR's publication. This was specifically discussed, for example, in the case of Magyar Farming Company Ltd, Kintyre Kft and Inicia Zrt v Hungary. In the award, the tribunal concluded that LIBOR +2% would be an appropriate rate to use in the given case, but then opted for a 'comparable' EURIBOR +2% due to an expectation for LIBOR to be phased out in 2022 with the result that the computation of interest may be rendered impossible beyond that date.

USD LIBOR ceased to be published in September 2024[24] and we expect to see tribunals move away from interbank rates. Since our dataset covers the period up to 2022, it is yet to be seen whether tribunals will increase their use of risk free rate benchmarks or will move to LIBOR replacements such as the secured overnight financing rate (SOFR) for the US dollar or sterling overnight index average (SONIA) for the British pound.

In the study period, we saw only three awards where this was considered, and in two[25] instances the tribunals simply noted that if LIBOR were to be phased out, interest should be based on whatever mechanism was put in place to replace LIBOR.

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[18] This is based on the rate awarded for a pre-award interest rate. The results for post-award rates are similar as most tribunals award the same rate for both.
[19] This was followed by Spanish government bonds due to the large number of Energy Charter Treaty (ECT) claims brought against Spain in recent years.
[20] Occidental Petroleum Corporation et al v Republic of Ecuador, ICSID Case No. ARB/06/11.
[21] Euro Interbank Offer Rate.
[22] For example, see Joseph Charles Lemire v Ukraine, ICSID Case No. ARB/06/18.
[23] For example, see Hrvatska Elektroprivreda d.d.v Republic of Slovenia, ICSID Case No. ARB/05/24.
[24] https://www.fca.org.uk/news/news-stories/us-dollar-libor-panel-has-now-ceased#:
[25] The third case is Magyar Farming Company Ltd, Kintyre Kft and Inicia Zrt v Hungary mentioned above where the tribunal opted for EURIBOR instead of LIBOR.

Weighted average cost of capital (WACC)

Relatively few tribunals in our sample decided that interest should be quantified using the claimant's WACC, being the average of all its funding costs. This would be the appropriate rate if the tribunal was seeking to award compensation that reflected the return that the claimant would have made from investing the money in expanding its normal operations. The return on its normal operations would typically be expected to cover the claimant's standard cost of financing its business, its WACC.

Regulatory return on investment

Another, less common, approach was to quantify interest using a regulatory return on investment. Some regulated industries, for example, telecommunications, have prescribed rates built into their pricing models to regulate the level of return made. As with awarding at the WACC, awarding at this rate assumes that the claimant would have invested the money in expanding its normal operations and garnering the permissible return.

b. Cost of borrowing

After return on investment, cost of borrowing was the next most popular choice of interest theory for tribunals.[26] What does this cost of borrowing represent? It is either the cost of funding a financing or cash gap (by taking on new debt) or it is the cost associated with the inability to pay off existing debt.

Commercial lending rate

In terms of quantification, many BITs include a clause that interest should be paid at a 'normal commercial rate', presumably assuming that, in lieu of actual borrowings undertaken, the claimant would have incurred a cost of borrowing on this basis. Claimants and tribunals often interpret a 'normal commercial rate' to mean something like LIBOR + 2%, but does this reflect the loss to the claimant? In one case, the claimants argued that the relevant company was not a large company and that LIBOR + 2% was not a suitable rate in these circumstances. The tribunal agreed with the claimants' assessment that 5% (rather than the usual 2%) should be added to the interbank rate as the claimants 'are not international companies and cannot borrow at only 2 points above the interbank offer rate'.[27] In another case, the tribunal chose the rate that should be applied based on publicly available information regarding the average rate for small business lending.[28]

Claimant's own borrowing rate

A more direct measure of a claimant's cost of borrowing may be to use the interest rate it would have paid had it borrowed the sum involved (this is the firm's cost of debt). This could be calculated either by observing the interest it paid on actual borrowing, or with reference to the cost of debt of analogous businesses.

Of the awards applying a cost of borrowing rate, just under one third used a cost of debt rate whereas just over two thirds favoured an interbank rate or risk-free rate. It is difficult to say with certainty why this is the case, but reasons for this would include availability of cost of borrowing information, jurisprudence and the rates requested by the claimants themselves.

c. Other rates

For some tribunals, legal considerations determined the interest rate to be applied. For example, interest was determined by a particular contract that was the subject of the breach, or national laws set a statutory rate which determined the approach.

In 55 awards, it is not clear on what basis pre-award interest is awarded – there is no record of the concept or measurement.[29] In some cases, the tribunal explicitly states that it has used its discretion to award interest, thereby circumventing any explanation.[30]

Negative rates

During the period covered by our research, there were certain times when commonly used interbank rates or risk-free rates were negative.[31] This presents a peculiar challenge for quantification of damages and calculation of interest. The principle that money today is worth more than the same amount in the future is foundational to the concept of the time value of money.[32] However, negative rates invert this principle, theoretically leading to the paradoxical situation where the amount owed by respondent diminishes over time as interest accrues.

Despite the prevalence of negative rates in certain periods, the arbitral awards in our study were generally silent on this issue. In one case where interest was granted at the rate of six-month EURIBOR + 2%, the tribunal simply noted without further discussion that it took into account that the rate awarded 'is at present negative'.[33]

[26] This refers to awards where it was possible to determine the concept of interest.
[27] Ioan Micula et al v Romania, ICSID Case No ARB/05/20.
[28] Stans Energy Corp and Kutisay Mining Limited Liability Company v the Kyrgyz Republic, PCA Case No. 2015-32.
[29] For example, see White Industries Australia Limited v Republic of India.
[30] For example, see Continental Casualty Company v Argentine Republic, ICSID Case No ARB/03/9.
[31] For example, EURIBOR rates were negative between 2015 and 2022 or rates of 10-year German government bonds were negative between 2019 and 2021.
[32] This is due to the earning potential of today's money, which can grow when it is invested.
[33] Flemingo DutyFree Shop Private Limited v Republic of Poland.

As with all things damages, the specific rates applied will be on a case-by-case basis: the extent to which a claimant would have been impacted by negative rates should be taken into account when determining the award of interest. In NextEra Energy Global Holdings BV and NextEra Energy Spain Holdings BV v Kingdom of Spain, the tribunal noted in its award dated 31 May 2019 that since its Decision on the award of interest, some 11 weeks earlier, the 5-year sovereign bond rate upon which interest was to be based had moved from 0.234% to 'essentially zero'.

The tribunal in this case found that 'an award of zero interest is not consistent with the conclusion of the Tribunal' that interest should compensate claimants for their loss of the opportunity to use their capital.

On this basis, the tribunal awarded interest at the March rate of 0.234% rather than at the May zero rate.

Pre-award and post-award

Another theoretical concept that led to differences in approach was the consideration of pre-award and post – award interest.

We found that in most cases the tribunal did not comment upon or distinguish between pre-award interest and post-award interest. However, some awards were explicit in their view that the two tranches are the same theoretically and should attract the same interest methodology.[34] Conversely, others took the view that the two are theoretically compensating for different scenarios and should therefore be measured differently.[35]

For those cases where the latter view was taken, tribunals used various mechanisms to distinguish between the pre-award and post-award elements. For example, tribunals opted for more frequent compounding intervals for post-award interest[36], increased rates compared to the pre-award rate and applied compounding for the post-award interest where a simple method was applied for the pre-award interest.

A key concern for tribunals, and one of the main reasons for imposing a more costly post-award approach, was the prompt payment of the amount awarded by respondents. For example, in Watkins Holdings S.à r.l. Et al v Kingdom of Spain, the post-award rate was determined to be 1% more than the pre-award rate 'to incentivise' the respondent's compliance with the award. Similarly, in Foresight Luxembourg Solar 1 S.à.r.l. et al v Kingdom of Spain, the tribunal selected a higher rate for post-award interest to 'facilitate prompt payment'. In Grenada; Vale S.A. v BSG Resources Limited, the tribunal noted that 'since post-award interest does not reflect reliance loss, but loss as a result of late payment under the Award, an interest rate that corresponds more closely to market rates for financial instruments is appropriate'.

The tribunal in AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v Republic of Kazakhstan took the opposite approach: the tribunal awarded semi-annually compounded pre-award interest but awarded only simple post-award interest and at a lower rate 'since the amount of the sum due has been fixed and the obligation to pay has been established by this award itself'.

Currency of rate

We found that in the few instances in which the currency of rate was specifically addressed by tribunals, there were different theoretical approaches applied: some tribunals felt that the currency of rate must equal that of the award currency[37], whereas others stated that the rate and award currencies did not have to match.[38]

In one case, the tribunal concluded that it was 'inappropriate in the circumstances to apply a U.S. Treasury bond rate to an award in a currency other than U.S. dollars' immediately after having decided to use the US Treasury bond rates for the calculation of interest on damages quantified in euros.[39]

[34] For example, see Ioan Micula et al v Romania.
[35] For example, see Gold Reserve Inc v Bolivarian Republic of Venezuela.
[36] Metalclad Corporation v United Mexican States, ICSID Case No. ARB(AF)/97/1.
[37] For example, see SD Myers Inc v Government of Canada, and Lion Mexico Consolidated v Mexico.
[38] For example, see CME Czech Republic BV (The Netherlands) v The Czech Republic.
[39] Bank Melli Iran and Bank Saderat Iran v Kingdom of Bahrain, PCA Case No. 2017-25.

Methodological differences

Methodological differences also accounted for some of the differences between tribunals.

When determining the method of calculation, tribunals must make an assumption as to the nature of the funding. For example, if the 'but for' scenario is that the claimant would have reinvested at LIBOR, what period of investment would the claimant have chosen? One month, three months, one year? Any of these tenors is feasible, and tribunals have chosen a variety of approaches.

Similarly, tribunals direct the parties on the compounding interval. If a one-year tenor is assumed, the economic corollary is that the compounding interval will be one year. However, as noted previously, tribunals often consider the tenor and the compounding interval separately. For example, we have seen a tribunal choose a six-month rate and instruct that interest be compounded annually.[40]

When selecting at which point in time a rate is taken, a tribunal might replicate the commercially compatible method of taking the rate at the beginning of each compounding period or alternatively, a tribunal will determine that average rates should be used to calculate interest.

Another example of differences in approach relates to the impact the length of period will have on interest calculated. For example, one tribunal reduced the compounding frequency because it felt that the resulting absolute amount of interest would be too high. Conversely, another tribunal felt that a more frequent compounding interval was appropriate given that the claimant had been without their money for so long.[41]

In some cases, tribunals seemed to opt for a certain interest rate simply because the other party did not object against it.[42] In others, rates suggested by both claimant and respondent were rejected and the tribunal came up with an entirely different rate.[43]

In most cases, one rate was used to calculate pre-award interest, however, in some instances tribunals applied different rates for different periods[44] or heads of claim[45], or excluded certain types of loss[46], such as moral damages, from entitlement to pre-award interest.

[40] Continental Casualty Company v Argentine Republic, ICSID Case No. ARB/03/9.
[41] See Occidental Petroleum Corporation et al v Republic of Ecuador and Ioannis Kardassopoulos and Ron Fuchs v Republic of Georgia.
[42] For example, see Antoine Abou Lahoud and Leila Bounafeh-Abou Lahoud v Democratic Republic of the Congo, ICSID Case No. ARB/10/4.
[43] For example, see PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v Republic of Turkey, ICSID Case No. ARB/02/5.
[44] For example, see Yukos Capital Limited v Russian Federation, PCA Case No. 2013-31. The tribunal used different rates for the calculation of pre-award interest for periods before and after the maturity of loans that were subject of the dispute.
[45] For example, see Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt, ICSID Case No. ARB/84/3.
[46] For example, see Desert Line Projects L.L.C. v Republic of Yemen, ICSID Case No. ARB/OS/17. The tribunal concluded that no pre-award interest is due on the amount for moral damages. In the Bernhard von Pezold et al v Republic of Zimbabwe award (ARB/10/15), the tribunal decided that, apart from moral damages, pre-award interest should not be awarded on certain properties because, in the tribunal's view, 'the Claimants, having remained in occupation of the Estates, have retained the benefit of creating value from their investments, which value they have subsequently reinvested. Thus, the "lost opportunity" of investing their money, for which Pre-Award interest is intended to compensate, has not truly occurred.'

Summary

Despite the potential importance of interest in determining the overall award made to a claimant, on average proportionally little space is dedicated to exploring the question of interest. Further, for approximately one third of the awards it was not possible to determine what the payment of interest represents conceptually. Our research has highlighted that differences exist.

Some of these are to be expected for good reasons such as the particular circumstances of the case and the variety of reasonable assumptions available.

However, our research also shows that there are areas where tribunals can reduce inconsistency, for example, the methodologies employed could be more aligned to the commercial application of interest.

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