Valuation Standards for Calculating ICSID Awards

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INTRODUCTION

Fair market value is the “price, expressed in terms of cash equivalents, at which the property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.” Fair market value is often the standard for deciding awards for investment treaty breaches, and its calculation is as much art as science. The lack of standards when calculating market value for determining awards creates an unnecessary source of uncertainty for investors, who are unsure ex ante whether claims are worth adjudicating, and by extension, whether legal protections for their investments are adequate.

The International Centre for the Settlement of Investment Disputes (ICSID) is an organ of the World Bank charged with adjudicating disputes between investors and foreign governments. ICSID was established in 1965 to encourage the cross-border flow of investments, especially to the developing world, by creating a forum through which aggrieved foreign investors can bring claims against host governments. Around the same time in 1964, William Sharpe published his theory of the Capital Asset Pricing Model, which would serve as a foundation of modern valuation theory by mathematically relating risk and return in a simple

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2 Mark Kantor, *Valuation for Arbitration: Uses and Limits of Income - Based Valuation Methods*, 4 TRANSNAT’L DISP. MGMT. 1, 6 (2007) (“Investment treaties, courts and commercial codes in many countries routinely acknowledge that the proper measure of compensation for injury to business interests is the impact on the company’s market value.”).
4 Id.
model. Both international arbitration and valuation practice have evolved greatly over the past forty-some years, but not in synchronization. The valuation of damages remains a source of uncertainty in ICSID arbitrations, and by extension a source of risk to international investments. While a body of scholarship examines the legal principles underpinning awards, the mathematics behind the calculation of awards has not received the same level of scrutiny.

The variation in mathematical approaches adopted by ICSID tribunals underscores the difficulty and subjectivity of calculating the impact of a government action on an investor’s business interests. Since 1981, the International Valuation Standards Council (IVSC) has been developing a set of standards to promote consistency and robustness in the calculation of market value. This paper discusses a framework where IVSC standards are given legal weight and serve as guidelines for the calculation of awards during ICSID proceedings.

Part 1 discusses issues in ICSID’s current approach to award valuation. Part 2 gives an overview of IVSC’s valuation standards and their development. Part 3 examines how applying IVSC standards would address valuation issues in ICSID arbitrations. Parts 4 and 5 explore the potential challenges of implementing a valuation standards framework for ICSID arbitrations.

I. CURRENT ICSID APPROACH TO AWARD VALUATION

No framework seems to underpin valuation analyses during ICSID arbitrations. After establishing the legal basis for an award, tribunals use their impression of valuation best practices as well as discretion to conduct the analysis. The result is a range of outcomes

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6 Capital Asset Pricing Model, FIN. VALUATION IN LEGAL CONTEXTS (Jan. 25, 2012), http://www.wfu.edu/~palmitar/Law&Valuation/chapter%202/2-5-0.htm (“A widely-used valuation model, known as the Capital Asset Pricing Model, seeks to value financial assets by linking an asset's return and its risk”).
dependent on the assumptions and philosophy of the adjudicating tribunal. Points of divergence include which valuation technique to apply and the application itself. In particular, CMS Gas vs. Argentina\(^9\) illustrates ICSID’s ad hoc approach to valuation analysis.

In the 1980’s, Argentina privatized its domestic gas distribution industry, and U.S.-based CMS Gas bought a 29.42% stake in Transportadora de Gas del Norte (TGN).\(^{10}\) The Argentine government issued a license to TGN for 35 years, with the possibility of renewal for ten additional years dependent on certain conditions.\(^{11}\) The government’s tariff payment to TGN “would be adjusted every six months in accordance with the United States Producer Price Index (PPI).”\(^{12}\) During Argentina’s early 2000’s economic crisis, the government froze PPI adjustments,\(^{13}\) which in effect decreased the value of the tariffs. Both parties agreed to submit to ICSID arbitration.\(^{14}\) The claimant sought to force the government to buy out CMS Gas’ shares in TGN.\(^{15}\) ICSID agreed with CMS Gas and assumed the task of determining the fair market value of the claimant’s stake in TGN.\(^{16}\)

Since the U.S.-Argentina Bilateral Investment Treaty did not address how fair market value should be calculated, the Tribunal decided to impose its own “discretion.”\(^{17}\) It considered five approaches\(^{18}\) for establishing fair market value. Among them were the “exchange” approach,
which valued assets by comparing them to similar assets that are publicly traded and the “discounted cash flow” (DCF) approach, which valued assets as the sum of projected cash flows discounted at a rate that reflected the uncertainty or risk of those cash flows.

The claimant argued for DCF because it explicitly accounted for the future profits of its investment and because of its common use in “international finance and international arbitration.” It conducted a DCF analysis and valued its shares in TGN at $261.1m. The respondent argued against DCF, because it resulted in the “gross overvaluation of the shares.” Instead it sought the “stock exchange valuation of shares of similarly situated companies.” The respondent declined to submit a valuation estimate.

The tribunal rejected the “exchange” approach since the Argentine gas distributors trading on the Argentine stock exchange were significantly different. In addition, it considered equities in Argentina currently to be an illiquid market, so the prices that companies traded for were not necessarily an accurate reflection of their fair value. The tribunal enthusiastically settled on DCF. It cited its perception that “DCF techniques have been universally adopted” and that “there is adequate data to make a rational DCF valuation.” The tribunal’s goal was to calculate “a range of values which can be rationally justified.”

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because “it is very difficult to imagine what uses or options there could be for gas transmission lines other than to transport gas.” See Id. at 119.

19 Id.
20 Id.
21 Id. at 114.
22 Id.
23 Id.
24 Id.
25 Id. at 115.
26 Id. at 119.
27 Id.
28 Id. at 121.
29 Id. at 122.
As a first cut, the tribunal used the valuation submitted by the claimant, which drew its data from “forecasted figures prepared by TGN for internal use.”\(^\text{30}\) The tribunal relied on expert testimony from both parties, and with the help of its own professionals on staff, parsed through the assumptions that went into the claimant’s DCF.\(^\text{31}\) The tribunal acknowledged the impact of its assumptions, since “depending on the choices of variables to which changes were made and the size of such changes, significantly disparate results were reached.”\(^\text{32}\)

The tribunal considered the ten-year potential extension of the license too speculative and thus limited the window of compensation to the remainder of the original 35-year contract.\(^\text{33}\) It faulted the claimant for not baking the impact of the Argentine economic crisis into its demand forecasts.\(^\text{34}\) The claimant responded that much of its demand had been locked in with contracts, but the tribunal asserted that “it would be highly unrealistic to assume that some adjustments to those ship-or-pay contracts would not have been made.”\(^\text{35}\) Noting that Argentina’s GDP declined 10.9% in 2002, the tribunal concluded “that it is reasonable to assume that sales revenues would have decreased by 5% in each of 2002 and 2003 and by 1% in 2004.”\(^\text{36}\) The tribunal reached this conclusion despite acknowledging that it did not have access to any studies on the “Argentine elasticity of demand with respect to gas prices.”\(^\text{37}\)

The tribunal next attacked the discount rate as too low. A low discount rate would increase the net present value of the claimant’s investment. The claimant used a “build-up” method starting with U.S. treasuries as the risk-free rate and layering on risk premiums to

\(^{30}\) Id. at 120.

\(^{31}\) Id. at 126.

\(^{32}\) Id. at 58.

\(^{33}\) Id. at 128.

\(^{34}\) Id. at 129.

\(^{35}\) Id.

\(^{36}\) Id. (Because the Argentine GDP rebounded in 2003 and 2004 at 8.8% and 7.8%, the tribunal gradually increased demand during 2005-2011 to about 3%, with a steady-state of 1.5% thereafter.).

\(^{37}\) Id. at 130.
calculate the return the claimant should expect given the riskiness of its investment in TGN.\textsuperscript{38} Its calculated return turned out to be “very close” to one the Argentine government had used in a 1997 tariff review.\textsuperscript{39} Nevertheless, the tribunal stated that in the 1997 review, the government was incentivized to cite an artificially low discount rate for two reasons. A higher discount rate suggested to potential investors that investing in Argentina was risky, and the government wanted “to project a positive image of that country as a foreign investment venue.”\textsuperscript{40} Secondly, a higher discount rate meant the government would have to pay more in tariffs to meet investors’ desired rate of return.\textsuperscript{41} On this basis, the tribunal increased the discount rate from 13.45% to 14.5%.\textsuperscript{42} With its respondent-friendly adjustments of claimant’s DCF analysis, the tribunal awarded the claimant $133.2m, about half of its desired $261.1m.\textsuperscript{43}

Whether the tribunal’s valuation work was performed correctly and reasonably is open to debate. Two points, however, stand out from its valuation methodology. First, the assumptions underlying the DCF analysis were significant enough to decrease the award from the requested $261.1m to the actual $133.2m. Secondly, the adjustments to the assumptions were almost entirely at the tribunal’s discretion, with little data or guidelines on best practices to back them up. For example, instead of applying several valuation methods and triangulating out a valuation, the tribunal chose to rely exclusively on DCF without applying additional methods to double-check the result.

\textsuperscript{38} Id. at 132.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
\textsuperscript{41} Id. (“the higher the cost of equity [the Argentine state regulatory agency] would set, the higher the tariff would be.”).
\textsuperscript{42} Id. at 133.
\textsuperscript{43} Id. at 136.
The tribunal concluded it had enough data for its assumption-laden analysis.\textsuperscript{44} In practice however, assumptions, such as demand growth, the exchange rate,\textsuperscript{45} discount rate, and cost projections,\textsuperscript{46} were pulled out of thin air based on little or no data. Given its budget and time constraints, the tribunal can only use its best judgment when faced with incomplete information. Adopting an analytical framework recommended by a recognized body of practitioners, however, would reduce the arbitrariness and increase the rigor of the application of individual judgment in award calculations.

II. Valuation Standards

The International Valuation Standards Council was formed in 1981 as the globalization of investments increased demand for professional valuation services of property interests.\textsuperscript{47} IVSC’s goal is to establish “internationally accepted standards for reporting the value of property.”\textsuperscript{48} The standards cover 1) an official set of definitions, 2) ethics and competency

\textsuperscript{44} Id. at 120. (“there is adequate data to make a rational DCF valuation of TGN”).

\textsuperscript{45} Id. at 131 (The tribunal stated the claimant’s assumption of a 3.59 peso-to-dollar exchange, the rate at the time the valuation was conducted, was too generous. It noted the peso had since appreciated to 2.97, which it concluded was “fairly representative of what value the peso could be expected to be in a stabilizing or a reasonably stable environment.”).

\textsuperscript{46} Id. at 135 (The tribunal determined the claimant’s projection of costs was too conservative. It considered the costs to be more fixed in nature than the claimant presumed, since “there is a significant amount of rigidity in this type of expenditures in a regulated industry where the maintenance of safety has to be paramount.” Given the tribunal’s assumption that demand decreased in the near term, these fixed costs would eat into margins and thus claimant’s future profits. When demand rose back after the dip, the tribunal believed that costs, despite their fixed nature, would rise because “the requirements for safety do not decrease and with aging equipment, maintenance expenditures will tend to rise.” The tribunal increased the claimant’s assumption of operations and maintenance expenditures as a percentage of sales from 7-10.2% to 8-11.5%.


requirements for the valuing professional, 3) procedures for going about the valuation, and 4) conventional wisdom regarding appropriate assumptions and models.  

Valuation standards originated in the 1930’s with the desire of American real estate appraisers to increase their fees by providing customers some assurance regarding the quality of their services. Standards establish a basis of objectivity customers can turn to if the valuation is disputed. The increasing sophistication of capital markets encouraged the spread of valuation standards to other asset classes. Periodic financial crisis increased the sense of urgency for standards development, and regulators reacted by establishing standard-setting bodies in their respective countries. The IVSC resulted from the collaboration of standard setting bodies in the U.S. and Britain. It develops standards for use in four contexts: 1) “financial statements,” 2) “transactions involving transfers of ownership,” 3) “decisions on loans and mortgages secured by property,” and 4) “litigation and tax settlements.”

The IVSC framework consists of six layers of publications, collectively known as the “White Book,” which is meant to be read as a single document. The highest and most authoritative layer is “General Valuation Concepts and Principles,” which “presents the

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50 See Id. at 2.
51 Id. at 3. (“Their objective was to build public trust by introducing regulations to prevent actual or perceived problems that arose in the work undertaken by their members.”).
52 Id. at 5. (“Although the acceptance of standards in the property markets is now long established, new markets are turning on to value. There is a rapidly developing recognition coming from outside the confines of the traditional valuation professions that the financial markets need valuation standards.”).
53 Id. at 4. (“Indeed, it appears that historically much of initiative for the creation of valuation standards has come from the regulatory sector, whether governmental or private.”).
54 Milgrim at 4.
55 White Book at section 3.1.1.
56 Milgrim at 10.
fundamental concepts and principles that underpin the valuation/appraisal discipline.” It articulates the definitions of general terms used throughout the White Book like property, ownership interest in property, and market value. It also outlines Generally Accepted Valuation Principles, which represent “accepted or best practice in the Valuation profession.” The next layer is the “Code of Conduct,” which sets ethical and competency requirements for a valuation work product to be considered valid. The third layer is “Property Types,” which tailor the general concepts and principles to four particular property types: real property, personal property, businesses, and financial interests.

The fourth layer is the Standards, which promote a common language for valuation work through the use of defined terms and lay out best practices that valuation professionals should adhere to. The fifth layer is Applications, which elaborate on the Standards for three common applications, 1) “Valuation for Financial Reporting,” 2) “Valuation for Lending Purposes,” and 3) “Valuation of Public Sector Assets for Financial Reporting.”

The sixth layer is Guidance Notes, which “provide guidance on specific Valuation issues and how Standards are to be applied in more specific business and service-providing situations.” Standards, Applications, and Guidance Notes are considered the meat of the framework and for interpretive purposes are equally weighted. Guidance Notes expand on Standards and Applications by providing implementation guidance for niche topics. They divide

58 Id.
59 Id.
60 Id.
61 Id.
62 Id.
63 Id.
64 White Book at 3.2.1 (“Standards, Applications, or Guidance Notes may be published as separate sections, each is a component part of the entirety…The Standards, Applications, and Guidance Notes… have equal authority.”).
into four areas: 1) “valuation of different types of property (real property, leasing, plant and equipment and personal property),” 2) valuation of property according to cash flow “(intangible assets, businesses and specialized trading property),” 3) “guidance on the application of valuation approaches (a cost approach for financial reporting and discounted cash flow analysis),” and 4) miscellaneous topics “(hazardous and toxic substances, reviewing valuations, mass appraisal for property taxation and historic property).”\textsuperscript{65}

An additional layer outside the White Book is white papers, which showcase the scholarship of IVSC members, but unlike White Book content, are not subject to public review.\textsuperscript{66} These papers serve the twin functions of 1) expanding the IVSC brand and 2) stimulating debate on issues in the profession. Commentaries represent another layer that is published without public review and is meant to address inquiries regarding interpretation of the White Book.\textsuperscript{67}

The IVSC bifurcates into Standards and Professional boards. The Professional board develops educational materials as well as ethical and competency standards for the profession.\textsuperscript{68} The Standards board maintains the White Book.\textsuperscript{69} From consulting peer organizations and soliciting feedback, the Standards board identifies areas of development and organizes a task force to address each one. The resulting work product is then subject to public review for at least

\textsuperscript{66} Ellis at 16.
\textsuperscript{67} Milgrim at 13.
Nine editions of the White Book have been published, the most recent being in 2011.\(^\text{72}\) The White Book can be a useful tool for award valuation analysis, because it is comprehensive and frequently updated. To the extent it is underdeveloped, the IVSC has shown enthusiasm for continuing to improve the breadth and depth with which the White Book addresses valuation topics. For example in 2004, IVSC released a guidance note addressing the valuation of mineral property in extractive industries. Drafted by mineral and petroleum valuation experts recognized in their industries, it provides instructions on the “appropriate application of valuation analysis to extractive industries properties,” what factors to consider in determining market value, and what are potential mistakes in the analysis.\(^\text{73}\) Given that 25% of ICSID cases relate to the oil, gas, and mining sectors,\(^\text{74}\) the extractive industries guidance note, as part of the White Book, provides a ready-made framework for parties to conduct their valuation analyses.

III. USING VALUATION STANDARDS FOR DETERMINING ICSID AWARDS

The White Book could serve as an additional source of law during award determinations, with the investment contract, the governing investment treaty, and customary international law taking precedence. Most investment treaties are silent on award calculations,\(^\text{75}\) and the


\(^{71}\) Id.

\(^{72}\) Lorente at 76 (article was written in 2009 when there were eight editions. Since then another edition was published in 2011, which is available at http://www.ivsc.org/pubs/index.html).

\(^{73}\) Ellis at 18.


\(^{75}\) CMS Gas at 118 (“…the Treaty offers no guidance as to the appropriate measure of damages or compensation…This is a problem common to most bilateral investment treaties and other agreements such as NAFTA.”).
application of market valuation in international investment disputes is still a relatively young concept.\textsuperscript{76} This leaves a substantial gap in the guidance available to tribunals for computing fair market values. The White Book can fill this gap by providing both substantive and procedural guidance for conducting valuation analysis.

\textit{CMS Gas} illustrates the White Book’s substantive guidance for valuation analysis. The governing treaty did not address determination of fair market value.\textsuperscript{77} Nor did the tribunal cite any precedents in its valuation analysis. To the extent the tribunal exercised its discretion, it could have done so with assistance from “Guidance Note 8: Depreciated Replacement Cost” and “Guidance Note 9: Discounted Cash Flow Analysis.”\textsuperscript{78}

GN8 provides a “surrogate” valuation methodology that was only briefly considered by the \textit{CMS Gas} tribunal.\textsuperscript{79} When there is not enough data to determine market value with confidence, GN8 suggests calculating depreciated replacement cost,\textsuperscript{80} which can then be used as another data point to compare against other market value estimates. Depreciated replacement cost is the “estimate of the Market Value for the Existing Use (MVEU) of the land plus the gross replacement (or reproduction) costs of improvement less allowances for physical deterioration and all relevant forms of obsolescence and optimization.”\textsuperscript{81} Thus the land TGN owned, plus the amount spent to build the distribution infrastructure less wear and tear and “functional/technical

\textsuperscript{76} The 1927 case of Chorzow Factory (1927 P.C.I.J. No. 9 (July 26)) of the now defunct Permanent Court of International Justice articulated the idea that compensation should be the fair market value of the property (“reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed”), available at http://www.worldcourts.com/pcij/eng/decisions/1927.07.26_chorzow.htm.
\textsuperscript{77} CMS Gas at 118.
\textsuperscript{78} Hereinafter respectively GN8 and GN9.
\textsuperscript{79} CMS Gas at 116 (tribunal considered “asset value or the replacement cost approach”).
\textsuperscript{80} \textit{International valuation guidance note 8: depreciated replacement cost}, INT’L VALUATION STANDARDS 6\textsuperscript{th} ED., Section 3.1 (“an acceptable method used in financial reporting to arrive at a surrogate for market value of specialised and limited market properties, for which market evidence is unavailable”), available at http://www.romacor.ro/legislatie/22-gn8.pdf.
\textsuperscript{81} GN8 at 3.1.
obsolescence,”\textsuperscript{82} could have been used to generate a market value to verify the result of the DCF analysis.

GN9 suggests there may be gaps in the tribunal’s valuation. The tribunal excluded the potential lease extension in the time horizon of the DCF.\textsuperscript{83} Section 5.1 of GN9 recognizes lease renewal may extend the time horizon, and setting the time horizon “is typically driven by market behavior that is characteristic of the class of property and its market sector.”\textsuperscript{84} Instead of dismissing the license renewal as speculative, the tribunal could have examined whether there was a history of similar businesses in the industry having their licenses renewed.

The tribunal relied exclusively on the build-up method for the discount rate.\textsuperscript{85} Section 5.1 states “discount rates should be selected from comparable properties or businesses in the market.”\textsuperscript{86} As a check for its built-up discount rate, the tribunal could have considered the discount rates used by competitor businesses in the industry. Section 3.4 states “theoretically, [the discount rate] should reflect the opportunity cost of capital, i.e., the rate of return the capital can earn if put to other uses having similar risk.”\textsuperscript{87} When the build-up method involves assuming risk premiums with little data to back it up, an additional outward-looking perspective from examining similarly risky investments could help the tribunal add bounds to those premiums.

The IVSC also provides procedural guidance for valuation analysis. It is publishing a Code of Ethics and a discussion paper titled “Definition of a Professional Valuer.” They provide a basis by which a tribunal can evaluate the credentials of expert witnesses and the credibility of

\textsuperscript{82} Id. at 3.11.
\textsuperscript{83} CMS Gas at 128.
\textsuperscript{85} CMS Gas at 132.
\textsuperscript{86} GN9 at Section 5.1.
\textsuperscript{87} Id. at Section 3.4.
their testimony. For example, the paper states that valuation professionals should possess three competencies: 1) professional skills, 2) technical skills specific to their analytical function, and 3) sufficient industry-related knowledge to make appropriate assumptions.\textsuperscript{88} The Code of Ethics covers principles like objectivity, due care, and professionalism.\textsuperscript{89} The tribunal could use these metrics when screening witnesses.

The White Book outlines steps to be followed during valuation analysis. For example under “Statement of Standard,” there is a checklist for “performing and reporting a Market Value estimate.”\textsuperscript{90} Such a checklist could not only guide expert witnesses in their valuation analyses, it could also serve as a reference by which the tribunal can evaluate the robustness of the analyses.

Another procedural benefit of the IVSC framework is the thoroughness with which it has crafted a common language and format for presenting valuation analysis. Throughout the White Book as well as the Glossary in the addenda, commonly used terms like “going concern value” and “cash flow” receive precise definitions. A common set of defined terms minimizes a potential source of disagreement and confusion during ICSID proceedings.

\section*{IV. STATUS AND FUTURE OF IVSC}

The IVSC’s ambition is to have the same relevance in the valuation world as the International Financial Reporting Standards Foundation\textsuperscript{91} and Financial Accounting


\textsuperscript{90} \textit{IVS 1 market value basis of valuations}, section 5.1 at p. 100, available at \url{http://www.romacor.ro/legislatie/07-ivs1.pdf}.

\textsuperscript{91} The International Financial Reporting Standards are the accounting standards used in many countries. Its main website is available at \url{http://www.ifrs.org/Home.htm}.  

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Foundation\textsuperscript{92} have in the accounting world. As of 2010, the IVSC consists of 67 delegates from 50 countries.\textsuperscript{93} Its primary sources of funding are 1) membership dues, 2) sale of published materials, and 3) corporate sponsorships,\textsuperscript{94} which together support a 2011 budget of $1.1m.\textsuperscript{95}

The International Accounting Standards Board (IASB), the standard setting body of the IFRS Foundation, had a 2008 budget of 16m British pounds.\textsuperscript{96} If IVSC does achieve such mainstream recognition, it will enjoy more resources and wider participation, which will improve the breadth and depth of its standards.

The U.S. counterpart of the IVSC is the Appraisal Foundation. The Savings and Loan crisis, during which many lending institutions failed from underwriting faulty loans, led Congress to regulate appraisal practice, which was covered in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.\textsuperscript{97} Title XI of the Act required that for transactions regulated by Federal regulatory agencies, “all appraisals shall, at a minimum: (a) Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation . . . unless principles of safe and sound banking practice require compliance with stricter standards . . . .”\textsuperscript{98} State appraiser regulatory agencies were required to “recognize and enforce the standards, requirements, and procedures prescribed under [Title XI].”\textsuperscript{99}
The Appraisal Subcommittee is a federal agency that enforces Title XI. It oversees the Appraisal Foundation, its self-regulatory organization (SRO) counterpart in the appraisal industry, which publishes USPAP, the American equivalent of IVSC’s White Book. In 2006, IVSC and the Appraisal Foundation issued a memorandum of understanding, known as the Madison Agreement, to eventually converge their respective standards into a single framework. The White Book currently has no legal weight and is adopted on a voluntary basis. Thus a convergence would improve its robustness as it receives increased scrutiny.

The biggest move IVSC has made to raise its profile is building linkages to IASB. As accounting moves to reporting assets and liabilities at fair value, the IVSC has sought to develop standards that “are consistent with the requirements of Valuers under [IASB’s] International Financial Reporting Standards [(IFRS)].” A recent example is the guidance note on the valuation of mineral property in extractive industries. It was written in reaction to an “Extractive Industries Issues” white paper published by IASB, which “express[ed] tentative opinions and alternatives for the principles on which to base the drafting of a financial reporting standard for the minerals and petroleum industries.” The IVSC concluded that several of the paper’s conclusions were based on an incomplete understanding of the valuation of mineral reserves, which led the Standards board to organize a task force to address this. Given such

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Id.
101 Lorente at 77.
103 White Book at 3.1.2.
104 Ellis at 15.
105 Id.
collaborations, the IASB has publicly acknowledged the IVSC as a “sister organisation.”\textsuperscript{106} The evolution of the White Book into a sister volume of IFRS will boost the White Book’s adoption and the input it receives, thus improving its comprehensiveness.

The IVSC currently advises prominent international organizations, like the Organization for Economic Cooperation and Development, World Bank, United Nations Economic and Social Council, International Monetary Fund, World Trade Organization, and the Basel Committee on Banking Supervision, on valuation issues.\textsuperscript{107} ICSID should also consult with the IVSC. Given that ICSID’s caseload has surged since 1997,\textsuperscript{108} its awards, and their proper valuation, will become increasingly influential for resolving or deterring investment disputes.

Given its comprehensive and ambitious mission,\textsuperscript{109} the IVSC is well suited to serve ICSID’s need for valuation standards. While the IVSC’s most prominent collaboration is with the IASB, financial reporting is but only one application of the White Book.\textsuperscript{110} It is more comprehensive than USPAP, which has a regulatory focus.\textsuperscript{111} With ICSID’s support, the IVSC could eventually establish an Application and Guidance Notes tailored to valuation in an international investment context. It could specifically address issues like determining the country-risk premiums that go into a discount rate and the time horizon when the license includes an option to renew, both of which were issues in \textit{CMS Gas}.

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\item[\textsuperscript{106}] Milgram at 8.
\item[\textsuperscript{107}] 2010 IVSC Annual Report at 13.
\item[\textsuperscript{108}] \textit{Total Number of ICSID Cases Registered by Calendar Year}, ICSID CASELOAD STATISTICS Issue 2011-2 at 7 (jumps from 3 cases in 1996 to 10 in 1997).
\item[\textsuperscript{109}] See Lorente at 78 (“…it was also agreed that the IVSC should be the international spokesperson for the [valuation] profession.”).
\item[\textsuperscript{110}] Ellis at 15 (“valuation for financial reporting is only one application of the standards contained in the IVS”).
\item[\textsuperscript{111}] \textit{Id.} at 14 (the White Book is “more comprehensive than the USA’s equivalent set of appraisal standards, Uniform Standards of Professional Appraisal Practice”).
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V. HOW TO GET BUY-IN FROM ICSID MEMBERS

Integrating the White Book into how ICSID calculates awards creates both procedural and substantive issues. The 1966 Convention on the Settlement of Investment Disputes between States and Nationals of Other States establishes the procedural framework for ICSID arbitrations. The ICSID Administrative Council can add Rules and Regulations to supplement this framework, which must be approved by a 2/3 majority of the Council. The Council consists of one representative from each member country, with each having one vote.

IVSC may have difficulty getting enough buy-in from ICSID members to exceed the 2/3 threshold. As of May 5, 2011, ICSID had 157 member countries, of which only 44 had a professional valuation association that was a member of IVSC. Four of IVSC’s members are from South America, five from sub-Saharan Africa, and eleven from Eastern Europe and Central Asia. ICSID has 43 members in sub-Saharan Africa, eight in South America, and 23 in Eastern Europe and Central Asia. Thus about 10% of ICSID’s sub-Saharan African members are represented in the IVSC, as are about half of ICSID’s South American members and less than half of its Eastern European and Central Asian members.

To get the buy-in of these developing regions, IVSC could adopt both bottoms-up and top-down strategies. At the grassroots level, IVSC could expand its membership in those regions,

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113 Id. at 12.
114 Id. at 13.
117 Id.
118 Supra n. 115.
119 Supra n. 117 and 118 (Sub-Saharan Africa: 5/43 =11.6%, South America: 4/8=50%, Eastern Europe and Central Asia 11/23 < 50%).
so that the member professional associations in countries of those regions can lobby on its behalf. Its Standards Board could craft Guidance Notes to address issues specific to developing countries. A step in this direction is the IVSC white paper “Valuation in Emerging Markets.”\textsuperscript{120} It addresses issues in emerging markets that constrain valuation analysis, such as “an inadequate legal framework, difficulties in obtaining information, greater economic volatility, outdated national valuation standards, lack of trained valuation experts, external pressures, excessive or insufficient government intervention, and transition towards the recognition of intangible property.”\textsuperscript{121}

Concurrently, the Professional Board could create training materials and perhaps subsidize the establishment of a valuation profession in countries that lack it. A long-term benefit of more valuation professionals in these countries is that they will broaden the pool from which ICSID draws tribunal members and expert witnesses, which will bring a valuable and currently underrepresented perspective to ICSID arbitrations.\textsuperscript{122}

With regard to top-down advocacy, the IVSC could articulate the added value of the White Book to arbitral award determinations. 61% of ICSID cases do not settle and instead are resolved by the tribunal.\textsuperscript{123} In 46% of those resolved cases, the tribunal awarded compensation to the investor claimant.\textsuperscript{124} Thus given that a substantial proportion, 28%,\textsuperscript{125} of ICSID cases result in awards, the proper valuation of these awards should be a major concern to all parties involved. Valuation standards would help address two common criticisms of ICSID, which are that the forum is biased against developing countries and its awards lack consistency.

\textsuperscript{121} Kantor at 12.
\textsuperscript{122} \textit{Infra} n. 131.
\textsuperscript{124} \textit{Id}.
\textsuperscript{125} \textit{Supra} n. 124 and 125 (46% of 61% = 28%).
The “perception of bias” led to Bolivia’s 2007 withdrawal, Ecuador’s 2009 formal denunciation of ICSID, and Argentina’s current reluctance to enforce ICSID awards. The nationality of tribunal members suggests the determination of ICSID awards is stacked against developing countries. Of tribunal members, 47% are from Western Europe and 23% from North America. Only 10% are from South America, 2% from sub-Saharan Africa, and 2% from Eastern Europe and Central Asia. The developing world has an especially strong interest in how ICSID awards are valued. South American governments are the respondent for 30% of ICSID cases, Eastern Europe and Central Asia 22%, and sub-Saharan Africa 16%. Written, objective standards might guard against any potential bias of tribunal members by forcing them to justify their valuation analysis to conform to such standards.

An infamous example of the lack of consistency in international arbitration is the Czech Republic cases, where two separate proceedings in the same forum adjudicating factually identical claims reached contradictory awards. ICSID awards lack consistency because

131 Id.
awards do not have precedential value and there is no appellate body to enforce uniformity.\textsuperscript{134} Without precedents and appellate decisions to look to, investors cannot form expectations on the possible values of an award. With standards to establish a process for valuing awards, however, both investors and foreign governments can enter investment agreements with more confidence regarding the basis behind a potential award calculation.

CONCLUSION

The ultimate purpose of valuation standards is not its mandatory and universal adoption; even the IVSC recognizes that a one-size-fits-all approach is not appropriate for an inherently subjective task like valuation analysis.\textsuperscript{135} Instead the value proposition is to add to the menu of terms over which investors and governments can negotiate in their investment agreements. If an investor finds the current ad hoc approach to valuation analysis to be a major concern, the host government can provide assurance by agreeing to the use of valuation standards when calculating arbitral awards. The government’s agreeing to use valuation standards might help it extract a favorable concession on other negotiated terms, and thus both parties get more of what they want.

The World Bank, which established ICSID, seeks to “reduce poverty and support development.”\textsuperscript{136} ICSID plays an important role in this aspiration. By protecting against the idiosyncratic risks of investing in unstable countries, investment agreements facilitate capital

\textsuperscript{134} Id. at 200.
\textsuperscript{135} See White Book at 3.2 (“it is intended that the International Valuation Standards and the national standards of respective Member States shall be complementary and mutually supportive”).
flows to less developed countries. ICSID enforces the integrity of these agreements. To the extent valuation standards add certainty and efficiency to the calculation of awards during investor-state disputes and investors can negotiate for use of these standards, a source of risk to investors is mitigated, a barrier to the cross-border flow of capital removed, and an opportunity to improve the material standard of living for millions created. “…[I]nternational investment law has tremendous potential to continue the encouragement of investment and development in countries that need it most, as well as to facilitate the global flow of capital to where it promotes economic growth best. It is a system worth saving as long as globalization exists.”

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138 Andrew Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 Va. J. Int’l L. 639, 657 (1998) (“The Model U.S. BIT allows the investor and the host to select the forum in which they wish to arbitrate their disputes. These include the International Centre for the Settlement of Disputes….”).

139 D’agostino at 229.