

# The Evidence an Expert Relies on in Damages Analysis



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# Scope of Expert Support

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- An Expert Report ought to include, among other things:
  - A basis in a theory of damages and/or instruction
  - An attempt at multiple valuation methodologies when valuing an interest in a business (or a discussion of why they do not apply)
  - Appropriate sources for evidence of history and forecasts
  - Appropriate disclosures of the process followed to come up with the results

*A direct, simple, and intuitive synthesis of the problem, the choice of solution(s), and the results.*

# What constitutes evidence? A few examples

- |   |   |   |   |   |
|---|---|---|---|---|
| X | Handwritten notes outlining plan to expand geographically or by product line                                  | ➔ | ✓ | Board of Directors' minutes with both sides of a joint venture approving an expansion                                 |
| X | An email from a banker friend suggesting the client would be able to get financing for a given transaction    | ➔ | ✓ | Market study by specialized firm  |
| X | An investment analyst computed "NPV 8", together with another 10 firms, all operating in different industries | ➔ | ✓ | Actual debt deal or firm letter of commitment   |
| X | An internal document discusses valuation is "conservative"  |   | ✓ | Cost of capital of the industry for a buyer evaluating an investment of comparable risk profile (FMV standard is key) |
|   |   |   | ✓ | How does the valuation match up with alternative methods or 'reality checks'.   |

# Documenting Business Decisions

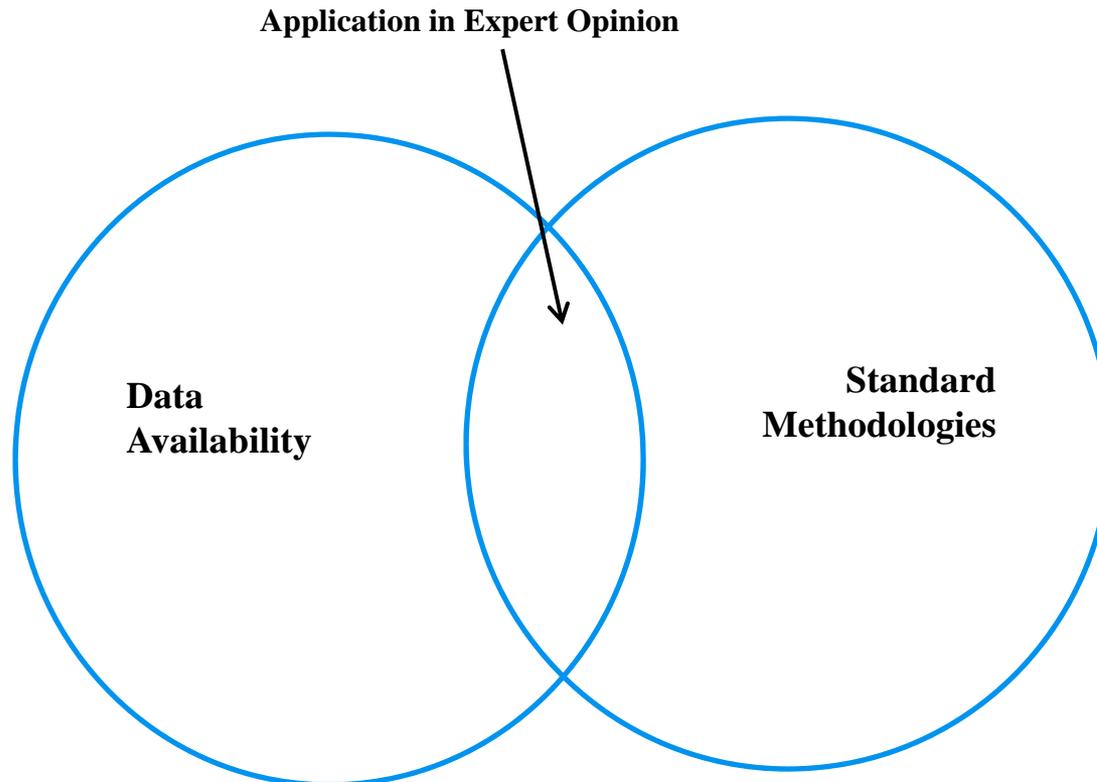
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- AFE-type documents: “Authorization for expenditure” or “PAF-Project Approval Forms” carry the weight of being standardized forms which assist management in comparing and executing business decisions.
- Board of directors or joint-venture board minutes.
- Documentation of the rationale for paying a premium over competing bids
- Getting management to memorialize meetings, plans and setbacks:
  - Joint or internal plans and business plans
  - Meetings outlining steps and plans
  - Meetings, calls, correspondence regarding setbacks

# Application of Valuation Methodologies

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- An overly simplified look at the expert's challenge

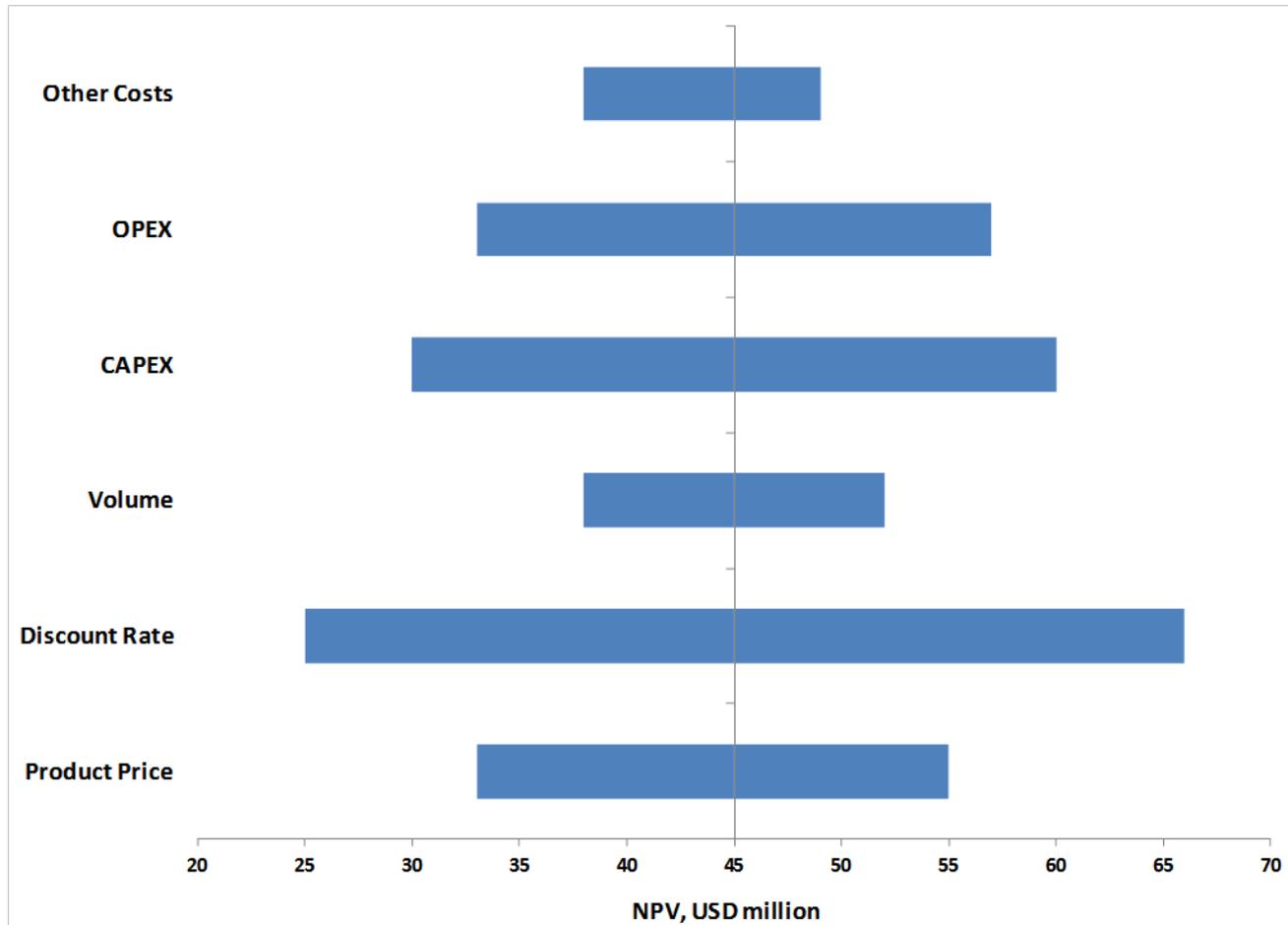


# Valuation Methodologies

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- Discounted Cash Flow (DCF)
- Market Based Valuations
  - Sales Comparisons (transactions)
  - Enterprise value / EBITDA ratios of publicly traded companies
- Event Studies
- Net Capital Contributions (NCC)
- Book Value

# DCF – Sensitivities: Tornado Chart Example



# Discount Rates

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## Corporate Planning vs. the Fair Market Value (FMV) standard

- Strategic value / investment value
- Rates used for benchmarking:

Investment bank reports include statements such as:

- *“...This is a standardized methodology to present “a value” of the proven reserves of a company. It is not meant to be an answer to our valuation problem, but rather to value all reserves in a fixed framework....”*
- *“.....The net cash flow after this is discounted at 10% (hence called PV10 – present value of future CF at 10% discount rate). “*
- *“The great thing about this measure is that it shows how different companies see their own cost inflation estimates (not future but for last year), although it is not terribly meaningful in terms of value of a company (no value ascribed to unbooked reserves or potential future finds).”*

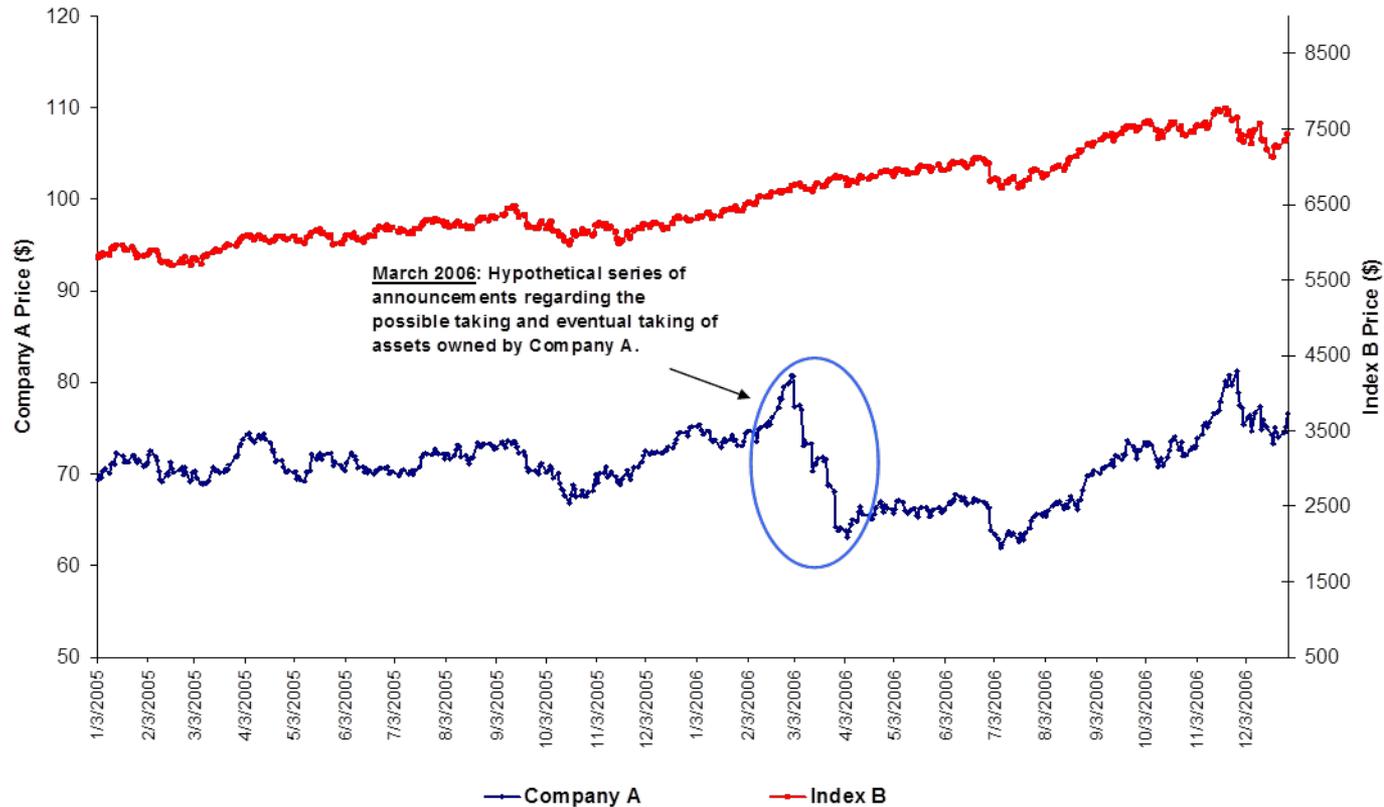
# Market Transactions

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- Main considerations:
  - Considering industry and project-specific characteristics
  - Direct comparability vs. need for adjustments
  - As benchmark or as primary method
  - Volatility and sensitivity to underlying parameters (commodity prices, risk, other)
  - Sources for information

# Event Studies / Stock Market Studies

Company A vs. Index B Price Performance



Source: Abrantes-Metz R., and S. Dellepiane (2011), "Using an Event Study Method to Compute Damages in International Arbitration Cases," *The Journal of International Arbitration*, Volume 8 No. 4.

# Summary

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- On evidence:
  - Encourage recordkeeping in documenting business decisions and investment alternatives
  - Work with counsel to understand what documents turn out to be useful in arbitration
- On expert appointment:
  - Be prepared to understand differences between in-house valuations and valuations for arbitration
  - Encourage the evaluation of multiple methods, even if an industry practice tends to focus on just one
  - Challenge your expert to avoid canned approaches

# Resources: a few recommended readings

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- On damages assessments in arbitration:
  - Mark Kantor, VALUATION FOR ARBITRATION, *International Arbitration Law Library* (2008)
  - Abdala, M. and P. T. Spiller, "Damage Valuation of Indirect Expropriation in International Arbitration Cases," *The American Review of International Arbitration*, Vol 14. No 4., 2003
  - Abdala, M. and P. T. Spiller, "Chorzów's Standard Rejuvenated: Assessing Damages in Investment Treaty Arbitrations", *Journal of International Arbitration*, Vol. 25, Issue 1, 2008.
- On the event study method:
  - Abrantes-Metz R., and S. Dellepiane (2011), "Using an Event Study Method to Compute Damages in International Arbitration Cases," *The Journal of International Arbitration*, Volume 8 No. 4.
  - David I. Tabak & Frederick C. Dunbar, *Materiality and Magnitude: Event Studies in the Courtroom*, in LITIGATION SERVICES HANDBOOK: THE ROLE OF THE FINANCIAL EXPERT (Roman L. Weil, Peter B. Frank, & Michael J. Wagner eds., 3rd ed., 2001

# Thank you

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