

International Arbitration in Regulated and Related Businesses: Why Hire Economists?

The late 1980s and 1990s witnessed a cascade of privatizations throughout the world. Triggered in the UK, but quickly spreading globally, it was propelled by changing government philosophies, the need to raise money, the transformation of command economies in Europe and the liberalization of the economies of Latin America. The result was that investors-owners were invited to purchase and operate infrastructure businesses in oil and gas, public utilities, highways, airports and railroads around the world.

Privatization to International Arbitration

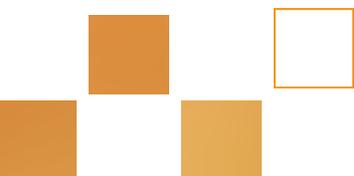
A growing number of these privatizations have failed. The resulting disputes between governments and investor-owners are overwhelming local regulators and avenues of legal redress, rising to the level of arbitration under sovereign international treaties. Such international arbitrations represent investor-owners' last chance to secure compensation for infrastructure investments gone very wrong.

International arbitration under such treaties is not new—but international arbitration for failed privatizations *is new*. Infrastructure business, by their very nature, are unusually capital intensive. Further, regulated businesses require the long-term government administration of pricing formulas that have no counterpart in competitive businesses.

Why Hire Economists?

Why hire economists to sort through these disputes and provide the best chance for the recovery of investments? There are four compelling reasons.

- **The principles of price regulation are the core.** The source of value for such businesses is tightly aligned with the reasonable administration of the critical principles of price regulation. Identifying the actions that caused regulation to fail, and regulated investments consequently to lose their value, demands the participation of economists with *deep credibility in international regulatory principles and practices* and the ability to relate those principles to the arbitral panel.
- **Well-known valuation principles often-enough do not apply.** Of the well-known techniques of valuation, some fail in the face of the expropriation of infrastructure. Tailoring those methods that *do* apply is complicated—requiring meticulous attention to the foundation for regulated charges, the methods for administering those charges and the subtle but real effects of governments and regulators on future prices and the expected return of investments with very long-term payback periods. Valuing the loss to investors in this environment demands economic expertise in *valuation in the context of regulation*.



- **Expert accounting is insufficient.** Regulated prices are constructed from accounts, but regulation alters both the form and purpose of such accounting. Particularly in developing countries, depreciation methods, taxes, currencies and exchange-rates all combine to form complex regulatory documents. Knowing how these combine to support the “regulatory compact” (the *quid-pro-quo* between investor-owners and governments), and how these factors combine in valuing loss, demands the participation of economists knowledgeable of these factors *in a regulated setting in developing economies*.
- **International arbitrations rely on economic valuation.** The trend in recent ICSID and ICC decisions is to reflect the economic costs incurred by complainants. Economic analysis to determine correctly all of the issues related to alleged damages demands specialized economic skills that are not typically in the purview of accountants or engineers.

NERA’s economists are unmatched in the field of privatization and the regulatory principles that accompanied investor ownership of such businesses around the world. We are the largest and oldest firm of regulatory economists. Our extensive experience in the workings of such markets and the litigation arising from disputes in them—extending back to our founding in 1961—combined with our deep expertise in regulated and competitive markets enables us to provide critical economic support in international arbitration cases both on the liability for the loss and the value of the claim. Our economists have helped law firms and companies navigate investment and contract disputes in many arbitration venues. We offer objective and independent economic and financial analyses and expert reports.

About Our Experts

NERA’s experts have consulted in disputes between global utilities and governments related to bilateral investment treaties, in arbitration cases between private parties concerning failed privatizations and political risk insurance policies, in pre-arbitration damage assessments for global utilities, in the process of contract renegotiation for the avoidance of arbitration and in the formulation of strategies for concession termination.

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Since 1980, Dr. Makholm has represented investor-owned businesses, industry regulators, and governmental agencies in many countries in all aspects of the economic regulation of electricity, gas, water and telecommunication utilities as well as road, railroads, airports and oil pipeline operators. Dr. Makholm has first-hand experience defining and applying “price cap” regulation around the world—where he has testified before public and private international arbitration panels, high courts and regulators dealing with electricity, gas, water and road transportation.

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Dr. Rosenzweig spent almost a decade in designing and implementing restructurings in power sectors in Asia and Latin America. He has worked with governments, regulatory commissions and private companies in these efforts. He has more than 25 years of experience in the energy area with an emphasis in regulation of infrastructure industries. He is a witness currently in four international arbitrations, two of which deal with failed power sector investments and two with a failed airport terminal project.

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Having helped to write the electricity market rules for the UK's major restructuring in 1990, Mr. Shuttleworth has advised energy companies, regulators and governments throughout Europe. His experience covers electricity markets and contracts, the use of "RPI-X" price caps (and other forms of incentive regulation) for energy networks in a European legal context. He has testified as an expert witness in arbitration proceedings in the UK related to the electricity sector.

About NERA

NERA Economic Consulting is an international firm of economists who understand how markets work. We provide economic analysis and advice to corporations, governments, law firms, regulatory agencies, trade associations, and international agencies. Our global team of more than 500 professionals operates in 21 offices across North and South America, Europe, Asia, and Australia.

NERA provides practical economic advice related to highly complex business and legal issues arising from competition, regulation, public policy, strategy, finance, and litigation. Our 45 years of experience creating strategies, studies, reports, expert testimony, and policy recommendations reflects our specialization in industrial and financial economics. Because of our commitment to deliver unbiased findings, we are widely recognized for our independence. Our clients come to us expecting integrity; they understand this sometimes calls for their willingness to listen to unexpected or even unwelcome news.

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