

**DCF VALUATION REJECTED - PROJECT “TOO SPECULATIVE AND UNCERTAIN” FOR DCF - METHOD TO BE USED IN DAMAGES ASSESSMENT**

*Bear Creek Mining Corporation v Republic of Peru* (ICSID Case No.ARB/14/21)

**Introduction**

By a decision handed down on 30 November 2017 in *Bear Creek Mining Corporation v Republic of Peru* (ICSID Case No.ARB/14/21), an ICSID arbitral tribunal found Peru liable to pay US\$18,237,592 million in damages with 5% per annum compound interest to the claimant Canadian company (in addition to 75% of the claimant’s arbitration costs plus interest) in respect of unlawful expropriation contrary to the Canada-Peru Free Trade Agreement 2008 (“the Canada-Peru FTA”).

**Background**

The claimant had the rights to operate a metal ore mining project in Santa Ana in Peru (“the Santa Ana Project”). On 29 November 2007, the Government of Peru issued Supreme Decree 083 declaring that the Santa Ana Project was a public necessity and authorising the claimant to acquire, own and operate the corresponding mining concessions and to exercise any rights derived from the ownership.

There was widespread social unrest in Peru focused on a foreign company owning and operating the Santa Ana Project. In June 2011, the Government of Peru issued Supreme Decree 032 purporting to nullify the claimant’s rights to operate the Santa Ana Project.

In 2014, the claimant commenced ICSID arbitration alleging, *inter alia*, that as a result of Supreme Decree 032 an unlawful expropriation without compensation had been committed by the Government of Peru.

In its Memorial, the claimant advanced a claim for damages based largely upon the Fair Market Value (“FMV”) of the Santa Ana Project on the date immediately prior to its expropriation by Peru (23 June 2011). The claimant adduced in evidence reports from independent experts concluding that the FMV of the Santa Ana Project as of 23 June 2011 was US\$224.2 million (excluding interest). This calculation was based upon the Discounted Cash Flow (“DCF”) method – whereby an estimate is taken of the total value of all future cash flows (both inflow and outflow) and then discounting them (typically using Weighted Average Cost of Capital (“WACC”)) in order to find the present value of that cash.

Further, the claimant alleged that the expropriation of the Santa Ana Project had caused damages to another of the claimant's projects in Peru ("the Corani Project"). The claimant's experts examined those damages at US\$170.6 million (excluding interest).

Accordingly, the claimant sought damages of US\$522.2 million.

## **Decision**

The Tribunal (comprising Professor Karl-Heinz Böckstiegel, President; Dr. Michael C. Pryles; Professor Philippe Sands QC) held that Peru had breached its obligations to the claimant. In particular, Supreme Decree 032 amounted to an unlawful indirect expropriation without compensation of the Santa Ana Project in breach of Article 812.1 of the Canada-Peru FTA. The Tribunal, on the basis of that finding, considered it unnecessary to examine and determine the claimant's other claims (including those based on failure to provide fair and equitable treatment, failure to provide full protection and security, and failure to avoid unreasonable and discriminatory measures). Further, the Tribunal (by majority) rejected Peru's argument that there was contributory fault and liability based on the claimant's contribution to social unrest amongst the local communities in Peru (unrest which, the Government of Peru claimed, had necessitated its actions).

Article 812 of the Canada-Peru FTA provided that, in the event of an expropriation, compensation "*shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value*".

However, the Tribunal held that this provision did not cover an 'unlawful' expropriation and therefore the standard of compensation had to be determined by reference to general international law. The parties agreed to use the FMV to quantify damages for an unlawful expropriation.

The Tribunal first considered what was the appropriate standard of compensation and concluded that the calculation of damages in the instant case could not be carried out by reference to the DCF method and the Santa Ana Project's potential expected profitability because the Santa Ana Project, at the time of the unlawful expropriation, had been too speculative and uncertain to be deemed viable. Instead, the Tribunal concluded that the measure of damages should be made by reference to the amounts that the claimant actually invested.

Having decided that the DCF method could not be used, the Tribunal next considered the assessment of damages based on what the claimant actually invested. The Tribunal noted that it appeared to be undisputed between the parties that the claimant invested a total of US\$ 21,827,687 for the Santa Ana Project.

The Tribunal accepted the argument that the Tribunal should award no more than US\$18,237,592 (representing the amount the claimant invested after the issuance of Supreme Decree 083). The Tribunal noted that the claimant was not claiming for expenditures prior to the issuance of Supreme Decree 083 and therefore accepted that the claimant's expenditures after the issuance of Supreme Decree 083 and up to the issuance of Supreme Decree 032 amounted to US\$18,237,592.

Professor Sands QC (in a partially dissenting opinion) considered that the damages awarded should be reduced (by half) to take account of contributory fault or liability on the part of the claimant. However, the majority of the Tribunal had held that Peru had failed to discharge its burden of proof in establishing contributory fault or liability and, accordingly, saw no reason to lower the damages award from US\$18,237,592.

The Tribunal next moved to consider compensation for the Corani Project and whether the claimant had established the alleged damages and the causal link between those damages and the expropriation of the Santa Ana Project.

The claimant had argued that, as a consequence of the expropriation of the Santa Ana Project, the claimant had had to raise more money at a higher financing rate while having fewer options with the consequence that the Corani Project had become more risky (as well as delayed with consequent loss of income) and that these losses were direct, normal and.

The Tribunal, however, considered that the claimant's witnesses had put forth contradictory evidence on the losses to the Corani Project and, therefore, the claimant had not discharged its burden of proof in this regard.

The Tribunal further held, on the basis of expert evidence that the Government of Peru's likely borrowing rate was in the range of 5.1% (as the weighted yield to maturity at the expropriation date) and 5.6% (the coupon rate of the most recently issued bond) per annum, that a rate of 5% compound interest was appropriate.

### **Concluding Remarks**

The DCF method is often used by parties and tribunals for the calculation of damages in investment treaty disputes containing expropriation claims. However, in this case the speculative and uncertain nature of the underlying project caused the Tribunal to consider that that commonly-used method was unsuitable.

As the perceived need for lawyers and arbitrators to achieve a better understanding of damages calculations grows stronger, the *Bear Creek* Tribunal's move away from DCF may be considered significant.

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