

# Four Key Takeaways of the Decision in Bear Creek Mining Corp v Republic of Peru

## Kluwer Arbitration Blog

December 16, 2017

Daniela Páez-Salgado (Assistant Editor for Latin America) (Herbert Smith Freehills)

*Please refer to this post as: Daniela Páez-Salgado (Assistant Editor for Latin America), 'Four Key Takeaways of the Decision in Bear Creek Mining Corp v Republic of Peru', Kluwer Arbitration Blog, December 16 2017,*

*<http://arbitrationblog.kluwerarbitration.com/2017/12/16/bear-creek-mining-v-peru/>*

---

The latest decision in *Bear Creek Mining Corp v Republic of Peru* (ICSID Case No. ARB/14/21) presents some interesting takeaways for international investment arbitration case law. This note briefly introduces the case's relevant facts before addressing the reasoning of the Tribunal in relation to (i) illegality as a bar to investment protection, (ii) indirect expropriation, (iii) the measure of damages awarded to the claimant, and (iv) the relationship between the action of foreign investors and local communities.

### • Introduction

This case concerned a Canadian mining company's (the "**Investor**") investment in Peru for the development of the Santa Ana mining project, located close to the border with Bolivia. In November 2007, the Investor had obtained through Supreme Decree 083-2007 the authorization to acquire, own and operate the corresponding mining concessions ("**Decree 083**").

The development of the Santa Ana mine was strongly opposed by local communities, which included violent protests against the mine operations and the Investor. In an attempt to deal with social unrest in the area and improve the situation, the government issued Supreme Decree 032-2011 which prohibited mining in nearby areas ("**Decree 032**"). Decree 032 had the effect of revoking the rights granted to the Investor under Decree 083, preventing the Investor from continuing its future operations of the mine.

The Investor thereafter filed an international claim against Peru arguing (among others) that Decree 032 constituted an indirect expropriation of its investment under the Peru-Canada Free Trade Agreement (the "**FTA**"). The Investor claimed damages of US\$ 522 million.

### • Illegality as a bar to investment protection

First, the Respondent objected to the Tribunal's jurisdiction to adjudicate the Investor's claims on the basis that the Investor had used a strawman to obtain Decree 083 in violation of Peruvian law.

Second, and in the alternative, the Respondent also challenged the admissibility of the Investor's

claims, alleging that the Investor had obtained its investment unlawfully.

In adjudicating the Respondent's allegations relating to the alleged illegal conduct by the investor in the obtaining of Decree 083 and the operation of the investment, the Tribunal looked at the plain language of the FTA to assess whether it contained any pre-conditions for a finding of jurisdiction based on the legality of the investment.

Because the FTA did not contain a specific provision requiring that the "investment be made in accordance with the law" or a good faith requirement, the Tribunal dismissed the jurisdictional objection. Likewise, the Tribunal found no basis in the FTA to deny admissibility, as there was no clear wording in the FTA providing for admissibility requirements.

The Tribunal held, though, that the allegations of illegality could be relevant to its analysis of the merits of the case. Indeed, the Tribunal looked at those allegations when deciding whether the Investor should be found liable on the basis of contributory fault. In the end, the Tribunal also dismissed Respondent's claims for liability of the Investor because Peru did not meet its burden to prove contributory fault.

- **Indirect expropriation under the FTA**

Consistent with the new generations of FTAs (such as DR-CAFTA), the FTA contains an annex that sets forth the test for determining whether an indirect expropriation has taken place. The Tribunal therefore interpreted and applied each of the elements in Annex 812.1 of the FTA to determine whether Decree 032 had constituted an indirect expropriation.

The first factor provided by Annex 812.1 refers to the economic impact of the "expropriatory measure". The Tribunal found that "*there was an obvious economic impact*" which had deprived the Investor of all major rights it had obtained through Decree 083 (¶ 374).

Second, the Tribunal found that Decree 032 had also interfered with the reasonable expectations of the Investor, who expected to develop its project in the next years based on the express governmental authorization it had acquired, i.e. Decree 083.

Third, to determine the "character of the measure" pursuant to Annex 812.1, the Tribunal engaged in a fact finding exercise. In particular, the Tribunal looked at the circumstances under which the governmental authorities issued Decree 032, noting that: (i) the authorities met on June 23, 2011 without inviting the Investor to participate, (ii) the evidence upon which Decree 032 was issued was not produced in the arbitration, so it was not able to assess the reasonableness of the revocation, (iii) the participation of a strawman in the authorization procedure was fully known and approved by the government so it could not have constituted a legal justification to revoke Decree 083, and (iv) the social unrest in the area was not caused by the Investor's conduct because its conduct was repeatedly endorsed by governmental authorities.

Having found that Decree 032 had an economic impact on the investment, that it violated the Investor's reasonable expectations and that the measure was not legally justifiable, the Tribunal found that Decree 032 constituted an indirect expropriation in the sense of Article 812 of the FTA.

- **"Cost approach" applied to the measure of damages**

When assessing the damages owed to the Investor due to the indirect expropriation, the Tribunal noted that the FTA was silent on the rules applicable to the calculation of damages. Both parties agreed on the use of the fair market value to quantify the damages, but disagreed as to whether the calculation should rely on the amounts invested (cost approach) or the potential profitability of the investment (calculated through the Discounted Cash-Flow methodology).

According to the Investor (relying on the test for early-stage projects from *Vivendi v Argentina [III]*), a willing buyer would have paid a price for the project calculated by the DCF method. The Tribunal concluded that the DCF method was not appropriate. The Tribunal pointed to the problems a hypothetical purchaser would have faced if interested in purchasing the Santa Ana project, such as: the project was at an early stage and had not received many governmental and environmental permits; the project faced opposition from local communities which would have made it hard to obtain the necessary social license to operate; and no track record of successful operation in the same area existed. Those facts for the Tribunal meant that a DCF approach would be too speculative for this case.

The Tribunal therefore adopted a cost approach methodology and awarded damages for the costs incurred in the development of the project prior to the issuance of Decree 032, totaling around US\$ 18 million.

#### • **Investor's relationship with local communities**

One of Respondent's illegality allegations was that the Santa Ana Project lacked a social license to build and operate in Peru and that the Investor had contributed to the social unrest and therefore to the issuance of Decree 032. The majority of the Tribunal found that Peru had not met its burden to show a causal link between the social unrest and the Investor's operations, and dismissed all illegality related allegations.

However, Prof. Philippe Sands QC (arbitrator appointed by the Respondent) disagreed. In his Dissenting Opinion, Prof. Sands appealed to the ILO Convention 169 to assess whether all the rights of the local communities located in the nearby areas of the Santa Ana project were given sufficient effect. In his analysis of the evidence presented by the parties, Prof. Sands concluded that a possible explanation for the adverse responses of certain communities to the Investor's project could be that the Investor did not engage the trust of *all* potentially affected communities and that even if the Investor was on notice of those numerous communities, it failed to take the appropriate steps to address the concerns of those communities (¶ 19). On this point, Prof. Sands would have reduced the amount of damages awarded to the Investor by one half for its contribution to the events that led to the issuance of Decree 032.

The approach taken by Prof. Sands is interesting in light of the increasing number of cases dealing with the interaction of investment protection and rights of indigenous communities. Other recent examples include, *Álvarez y Marín Corporación S.A. and others v Panama* (involving claims of invasion of the investors' properties by indigenous groups) and *South American Silver Limited v Bolivia* (involving claims of investor misconduct in its relationship with neighboring local communities to a mining project).

Finally, on a curious note, notwithstanding this dispute, Bear Creek Mining will keep doing business in Peru developing other project. The company's official [press release](#) after the award states that Bear Creek "look[s] forward to accelerating the advancement of our Corani project in conjunction with the Government of Peru and the Corani communities."