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Future Profits vs Cost: When do Tribunals Consider a Damages Claim Too Speculative?

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Recently published arbitral awards provide insight into Tribunals' reasoning when the quantum of a claim is challenged for being too uncertain or speculative.

Typically, Claimants will not only claim costs incurred up to the date of the breach or expropriation, but they will also claim compensation for future profits in a but-for scenario. However, a recurring challenge raised by Respondents and/or their experts, in particular where a project or business has little or no track record of profits, is that future projections are too speculative, so that Claimants' compensation should be limited to costs already incurred.

I provide below examples of recent arbitral awards where this point was raised, and I summarise the reasoning adopted by Tribunals in each case.

Generally, it appears that Tribunals use several criteria to assess future projections, including (i) the past track record of the project or business, (ii) the length of the projections, (iii) the ability to continue operating, and to operate profitably, over the projection horizon, (iv) the stability and predictability of future revenue and costs, and (v) the availability and reliability of evidence to support projections. Recent decisions show, however, that these different criteria are not weighted equally, and that Tribunals tend to focus more on future profitability than past performance.

Ability to generate future cash flows

Tribunals have refused to compensate investors for future profits when there was insufficient evidence that the projects could generate positive cash flows. In *Bear Creek Mining Corporation v. Republic of Peru* (ICSID ARB/14/21), Bear Creek, a Canadian mining company, claimed US$224.2 million in damages following the revocation in 2011 of its mining concessions for the Santa Ana silver mining project in Peru.

The concessions had been granted in 2007 and 2008. The Claimant had started exploration activities and had applied for a mining permit. The Claimant sought to prove that the project would have been able to move into the production phase but for

the actions of the Respondent and claimed the fair market value of the project using the Discounted Cash Flow (DCF) method. According to the Respondent, the use of an income-based measure of value, such as DCF, would be highly speculative given that the asset was not a going concern and had no history of operations or profitability.

The Tribunal considered that the evidence presented by the Claimant was insufficient to support their claim that a hypothetical purchaser of the project would have been willing to pay a price based on DCF projections. Moreover, the Tribunal was unconvinced that there was evidence that the project had an ability to produce profits. The Tribunal awarded Bear Creek its sunk investment costs of US$18.2 million.

Similarly, in *Clayton and Bilcon of Delaware Inc. vs. the Government of Canada* (PCA Case No. 2009-04), the Claimants acquired in 2004 a quarry in Nova Scotia to develop alongside a marine terminal. In 2007, the project failed its governmental Environmental Assessment (EA) so could not proceed. The Claimants considered that they were unfairly treated by the Government of Canada during the EA process and filed a claim under NAFTA. The Claimants argued that their project would have passed the EA process had it been treated fairly and claimed US$443 million in compensation for future profits over the life of the project (50 years). The Respondent pointed out that the obtention of the EA was not certain and that the project may have failed anyway regardless of the NAFTA breaches.

The Tribunal found that the Claimant failed to prove there was sufficient certainty that the EA would have been granted or that the project would have been economically viable. The Tribunal awarded compensation for loss of opportunity which it estimated at US$7.0 million on the basis of costs incurred before it became clear the EA would not be obtained.

Stability and predictability of future cash flows

In five solar power cases against Spain, Tribunals awarded compensation for lost future profits even if the power plants did not have a long history of operations. In *Eiser Infrastructure Limited and Energia Solar Luxembourg S.à.r.l vs. the Kingdom of Spain* (ICSID ARB/13/36), the Claimants requested compensation for the loss in value of their investments in three Concentrated Solar Power (CSP) plants following a change in feed-in tariff incentives enacted by Spain in 2013. The plants had been operating since May 2012.

The Claimants based their calculation on the cash flows that would have been generated by the CSP plants over their useful life (40 years according to the Claimants) had the original incentive legislation been maintained. Respondent claimed that the DCF method was not appropriate due to the long time-period of the projections (25 years according to the Respondent) which made assumptions used in the DCF model highly uncertain. Instead, the Respondent relied on the Regulatory Asset Base (RAB) of the plants, *i.e*. the cost of building and maintaining the plants.

The Tribunal considered that power stations have a relatively simple business model, producing electricity whose demand and long-run value can be analysed and modelled

in detail based on readily available data. They also noted that the plants were still in operation. The Tribunal concluded that the Claimants could be compensated for lost future profits over a 25-year period.

A focus on the future

Some Tribunals have put a clear emphasis on the future profitability of a project or business as opposed to their history. In the words of the Tribunal in *East Mediterranean Gas S.A.E. v. Egyptian General Petroleum Corporation and Egyptian Natural Gas Holding Company and Israel Electric Corporation Ltd* (ICC, 18215/GZ/MHM):

> [Respondent] has, additionally, raised an objection as to the accuracy of a DCF model, given the lack of record of [Claimant]'s profitability. The Tribunal sees no reason for concern. **The important fact is not whether [Claimant] can prove its profitability in the past, but rather whether it is reasonable to presume that, were it not for [Respondent]'s wrongdoing, it would have obtained a foreseeable stream of income in the future.**

This approach is illustrated in *Process and Industrial Developments Limited v. The Ministry of Petroleum Resources of the Federal Republic of Nigeria* (January 2017). In that case, the parties entered into a 20-year Gas Supply and Processing Agreement (GSPA) in 2010, whereby Nigeria would supply Wet Gas to P&ID (the Claimant) which would process it in a newly-built facility and return it in the form of Lean Gas.

Nigeria did not make the necessary arrangements for the agreed supply of Wet Gas, including building the necessary pipelines. In March 2013, the Claimant treated this as a repudiation of the GSPA. By that date, the Claimant estimated that it had invested US$40 million in the project, although it had not yet acquired the land or built the facility.

The Claimant estimated that the project would produce a net profit of US$5 billion to US$6 billion over a 20-year period. The Respondent objected stating that the Claimant should only be entitled to nominal damages as it had not fully performed its obligations under the GSPA at the date of the repudiation. The Respondent also insisted that damages could only be awarded for a period of three years as the Claimant had a duty to mitigate its loss and it should have pursued other investment opportunities.

Despite the repudiation occurring at a very early stage of the contract, the Tribunal considered that there was no evidence that the Claimant would not have performed its obligations if it had been supplied with Wet Gas. In other words, in a but-for scenario, the evidence indicated that Claimant would have been able to operate a profitable business, and the lack of past operating history was not a decisive factor for the Tribunal in the circumstances. The Tribunal awarded full compensation over the full

length of the contract, so US$6.6 billion before interest.

In conclusion, these cases illustrate the approach taken by Tribunals to decide whether the Claimants should be compensated for their future profits or only for the costs already incurred. As shown above, Tribunals tend to focus on the evidence supporting the ability of a project or business to produce future profits rather than on their past performance and rely heavily on the particular facts of each case.

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