

## Resource nationalism--the emergence of a new theme in arbitration?

05/06/2015

**Arbitration analysis: Mongolia's Dornod uranium deposit, one of the largest in the world, has played host to a contentious instance of resource nationalism. Ian Laird, partner at Crowell & Moring LLP, examines the issues raised in Mongolia v Khan which promises to set a significant precedent in arbitrating over expropriations, and the award of damages.**

### Original news

Khan Resources Inc & Ors v Government of Mongolia (PCA Case No 2011-09)--Award dated 2 March 2015

On 2 March 2015, an UNCITRAL tribunal issued its award on the merits in the arbitration proceeding between Khan Resources, Inc (and others) and the Government of Mongolia (and another) (PCA Case No 2011-09). The tribunal found that the respondents had illegally expropriated the claimants' investments, in the form of mining licences, in breach of national investment law and the state's obligations pursuant to the Energy Charter Treaty. The tribunal awarded the claimants \$80,000,000 in compensation (plus interest and costs). The tribunal's award was made public in May 2015.

### What was the background to the dispute and hearing?

On 2 March 2015, a distinguished international tribunal (composed of Mr David Williams, QC (President), Maitre Yves Fortier, QC, and Dr Bernard Hanotiau) rendered a \$100m award in favour of the Canadian uranium mining company, Khan Resources, Inc (Khan). The tribunal compensated Khan for the 2009 expropriation of its mining licenses by the Government of Mongolia. Counsel for Khan was Crowell & Moring LLP. The legal team included: Ian Laird (DC Partner), George Ruttinger (DC Partner), Ashley Riveira (DC Counsel), Kassi Tallent (former Crowell DC Counsel), Joanna Coyne (DC Associate), and a DC practice support team that included Staci Gellman, Alex Erines, Rachel Tecott, and Chris Williamson. Mongolia was represented by Michael Davison, Laurent Gouiffès, Markus Burgstaller and Thomas Kendra of Hogan Lovells (Paris) LLP.

Khan initially invested in Mongolia in 2003 when its subsidiary CAUC Holding acquired a 58% interest in a joint venture company known as CAUC, whose sole aim was to develop one of the largest uranium deposits in the world, the Dornod deposit in north-eastern Mongolia. Representatives of the governments of Mongolia and Russia each held 21% stakes in CAUC, which was the owner of a mining license issued by the Government of Mongolia. In 2005, Khan also obtained exploration rights over an adjoining property through its Mongolian subsidiary, Khan Mongolia. This additional property covered part of the underground Dornod deposit and was to be developed jointly with the original property. As the date for commencement of commercial production of the Dornod deposit drew near, Mongolia embarked on a campaign of administrative action and legislative reform aimed at excluding Khan from its own project explicitly in favour of the Russian partner. As its dispute with Mongolia was developing, Khan sought assistance from Ian Laird, partner in the DC office of Crowell & Moring LLP.

### In summary, what were the claimants' claims (and what were their legal bases)?

In January 2011, Crowell & Moring filed a notice of arbitration against the Republic of Mongolia on behalf of Khan and its subsidiaries, CAUC Holding and Khan Netherlands. The claims in the arbitration arose under two separate instruments of consent, one contained in the CAUC joint venture contract and the other contained in the Energy Charter Treaty. Thus, some claims were brought under Mongolian civil law (such as under Mongolia's Foreign Investment Law), while others were raised under international law.

### On what grounds did the tribunal find that the claimants' investments had been expropriated?

Mongolia made a number of early objections to the claims on various jurisdictional grounds. After two hearings held in 2011 and 2012, the tribunal dismissed all of the objections and the arbitration proceeded to the merits phase. A final merits hearing was held in November 2013 in Paris and the final award on the merits was rendered on 2 March 2015 in favour of Khan.

Khan's counsel advanced claims under Mongolian law and international law. In its liability decision, the tribunal accepted almost all of the legal analysis submitted by Khan's legal expert, while rejecting the analysis of Mongolian law by the Government's expert. The tribunal ruled that:

- o Mongolia had expropriated both Khan's licence rights and its contract rights
- o this deprivation was carried out as a penalty against Khan
- o the deprivation was illegal under Mongolian law

Notably, the tribunal found that the respondents' motivation in invalidating the licenses was 'the prospect of developing the Dornod deposits at greater profit with a Russian partner'.

### **How did the tribunal approach the assessment of damages and interests, and why is the award significant?**

The tribunal awarded Khan \$103m in damages and interest. It based its damage award of \$80m on a fire sale offer to buy Dornod in 2010, to which the tribunal added a premium of 100% to account for the adverse impact of Mongolia's actions on Dornod's value. The tribunal also awarded costs of \$9m, including attorneys' fees of \$7m. The award is significant because:

- o although the tribunal did not use the discounted cash flow method for calculating damages as advocated by Khan, it recognised that this was an appropriate measure of damages for a project like Dornod, even though it was not an operating mine, because Khan had produced a feasibility study establishing the presence of substantial uranium reserves, and
- o the tribunal awarded Khan 100% of its legal fees, including a success fee provided for in Khan's fee agreement with Crowell & Moring

### **What should investment treaty arbitration practitioners take from the award?**

The Khan award follows the recent trend of increasing international disputes in the natural resources sector. This trend apparently follows a re-emergence of resource nationalism leading to conduct of an expropriatory nature by many states. The case is also an example of how investment treaty arbitrations can be based on a mixture of applicable laws (in this case--both Mongolian law and international law), thus requiring a careful selection of local law experts. As noted by the tribunal, the testimony of Khan's Mongolian law expert was pivotal to the tribunal's decision.

*Interviewed by Julian Sayerer.*

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.*