Chapter 11

Valuing Natural Resources Investments

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1 Introduction

This Chapter focuses on current issues arising in the quantum analysis for natural resources investments. We analyze the extractive industries, such as mining and oil and gas, and the renewable energy industry. These industries are considered together because they are frequently the subject of investor-State disputes, often involve licenses or regulatory regimes overseen by States, require large amounts of upfront investment, and produce commodities that are sold into well-developed markets.

Quantum calculations in these industries follow general valuation principles but often require separate consideration of industry-specific features. An expropriation claim, whether full or partial, often requires the valuation of the entire expropriated investment. The same is true in matters involving fair and equitable treatment (“FET”) and other claims, which arise from measures that are alleged to have deprived claimants of the full value of their investment. Even in cases where valuing the affected asset as a whole is not necessary, quantum calculations rely on methods, inputs, and assumptions underlying a traditional valuation analysis.

In this Chapter, we first describe the reasons for the prevalence of natural resources investment claims (Section 2) and then summarize the relevant industry valuation standards and key drivers of investment value (Section 3), before discussing three key damages issues often debated in extractive and renewable energy cases. We analyze the underlying financial and economic fundamentals of each issue, review the principal legal authorities, and develop conclusions.

We conclude that: (i) reliable cash flow projections can often be developed for extractive and renewables projects, making the discounted cash flow (“DCF”) method superior to other valuation methods for many projects, even for some early-stage projects (Section 4); (ii) the market approach (comparable transactions/comparable companies methods) is often unreliable because

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it can fail to account for individual project characteristics (Section 5); and (iii) when claimants in these sectors have publicly traded shares, share prices can provide useful information about potential value (Section 6).

2 The Prevalence of Investor-State Disputes in the Natural Resources Sector

The natural resources sector has accounted for nearly a quarter of all investor-State arbitrations reported by UNCTAD and an even higher proportion among recent cases.¹ Damages claims in natural resources disputes are disproportionately large. Natural resources cases comprised 49 of the 146 (34%) investment cases known to UNCTAD with claims in excess of $500 million.²

Many, often large, claims arise in the natural resources sector because of the nature of the investments:

- States are frequently counterparties in natural resources investments and are therefore the likely respondents when disputes arise. States, for example, are typically responsible for granting exploration and extraction licenses for mining and oil and gas investments, and are often joint-venture partners or counterparties to purchase agreements or production sharing contracts. Similarly, in the renewables industry, State subsidies and other regulatory programs can be essential to an investment’s economic viability and changes to these regulatory schemes have triggered recent cases.

- Projects typically involve large, upfront investments. There are even megaprojects,³ like the Kashagan oil field in the Caspian Sea, which required $50 billion in investment over 16 years.⁴ Similarly, Spain saw well over

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¹ UNCTAD reports 817 investor-State cases through July 31, 2017. There are 182 natural resources cases comprised of extraction of crude oil and natural gas (64 cases), mining and quarrying (65 cases), and renewables (53 cases). Among the 449 cases filed since 2010, 129 (29%) involved investments in this sector. UNCTAD, INVESTMENT DISPUTE SETTLEMENT NAVIGATOR (July 31, 2017), http://investmentpolicyhub.unctad.org/ISDS. The statistics exclude cases involving mining support service activities.

² Id.

³ Megaprojects are projects that require very significant upfront investment or expect unusually high production levels.

⁴ Nariman Gizitdinov, Oil From $50 Billion Kashagan Field Starts Flowing to Export, BLOOMBERG (Oct. 14, 2016).