SUMMARY OF *THE KALOTI V. PERU* CASE

14 MAY 2024

On Tuesday, 14 May 2024, an international arbitration tribunal ("**Tribunal**") constituted under the ICSID Convention and the United States-Peru Free Trade Agreement ("**Treaty**) issued its final award ("**Award**") in *Kaloti Metals & Logistics, LLC v. Republic of Peru* (ICSID Case No. ARB/21/29) ("**Arbitration**"), rejecting the entirety of Claimant's claims on jurisdictional grounds and ordering Claimant to reimburse Peru for 100% of its arbitration costs.

This latest victory is Arnold & Porter's fifth consecutive, complete victory for Peru,[1] and contributes to the firm's industry-leading 98% success rate for sovereign States in investment arbitrations. The firm's track record currently stands at 54 positive results out of 55 awards and decisions on behalf of States in investment arbitrations.[2]

The Arbitration concerned a series of shipments of gold ("**Shipments**") that were due to be exported from Peru to the United States in late 2013 and early 2014 but were precautionarily seized by Peru's authorities in the context of investigations and criminal proceedings regarding illegal mining, money laundering, and related crimes ("**Challenged Measures**").

The Arbitration raised several critical aspects of investment arbitration, including international tribunals' lack of jurisdiction over investments made in violation of national law and international public policy, and States' right under international law to adopt measures designed to protect legitimate public interests.

Background

Over the past 10 to 15 years, Peru and other gold-producing States have experienced dramatic increases in illegal gold mining. Illegal mining has wreaked havoc on local communities and their environments, resulting in the dumping of large quantities of mercury into the rivers of the Amazon. In addition to its devastating effects on the environment, illegally mined gold ("**dirty gold**") is often closely linked to money laundering, as well as other crimes such as racketeering, child labour, sexual exploitation, other forms of violence and intimidation, tax evasion, and countless others.

From 2010, Peru responded to the emerging crisis fueled by dirty gold by developing its legal framework to combat illegal mining and related crimes. In that context, Peru's authorities increased export controls, and regularly reported indicia of potential money laundering and illegal mining activities to the Prosecutor's Office, which in turn launched criminal investigations to uncover illegal activity related to illegal mining.

[1] In addition to its victory in the present case, Arnold & Porter has secured complete victories for Peru in *Panamericana Televisión S.A. et al v. Republic of Peru* (PCA Case No. 2019-26) (see here); *Worth Capital Holdings 27 LLC v. Republic of Peru* (ICSID Case No. ARB/20/51) (see here); *Latam Hydro LLC and CH Mamacocha S.R.L. v. Republic of Peru* (ICSID Case No. ARB/19/28) (see here); and *Hydrika 1 S.A.C. and others v. Republic of Peru* (ICSID Case No. ARB/18/48) (see here).

[2] See our wins brochure here. The firm's track record encompasses all awards or decisions which, at the time of issuance, constituted a final ruling (or a potentially final ruling, *e.g.*, an award that at the time of issuance was final but was subject to an annulment application). Accordingly, the tabulation does not include (i) partial or interim awards, (ii) jurisdictional decisions that did not dismiss the claims, or (iv) provisional measures decisions, since none of those constitute final overall decisions.

Pursuant to that legal framework, investigations by Peru's authorities in late 2013 and early 2014 identified strong indicia of criminal activities—including money laundering and illegal mining—in relation to both the Shipments and the local suppliers of the gold ("**Suppliers**"). These investigations led to criminal charges filed against the Suppliers. Peruvian criminal courts subsequently ordered the precautionary seizure of four of the Shipments during the pendency of the judicial proceedings.

Claimant in this arbitration was Kaloti Metals & Logistics LLC ("**Kaloti**"), the Florida-based arm of a large, Dubai-based, precious metals conglomerate (the "**Kaloti Group**"). Both before and after the adoption of the Challenged Measures, numerous articles and investigations by global media outlets and NGOs (such as Bloomberg, the BBC, the Financial Times, The Guardian, Global Witness, and the Organized Crime and Corruption Reporting Project) have reported on suspected illegal activity by Kaloti and the Kaloti Group, including forged audit reports, smuggling gold out of Morocco, purchasing conflict minerals, funding global criminal organizations, and money laundering on a massive scale.[3]

Kaloti's claims

In the Arbitration, Kaloti claimed that the Challenged Measures had unlawfully interfered with its property rights over the Shipments, as well as with its broader operations in Peru, the United States and other countries, in alleged breach of Peru's obligations under (i) Article 10.5 of the Treaty, which affords minimum standard of treatment to covered investments; (ii) Article 10.3, which prohibits Treaty Parties from discriminating against foreign investors on nationality grounds; and (iii) Article 10.7, which prohibits unlawful expropriations. On that basis, Kaloti sought more than USD 154 million in compensation.

Peru's arguments

Peru submitted that all of Kaloti's claims fell outside the Tribunal's jurisdiction, including because Kaloti had failed to prove that it owned an investment covered by the protections under the Treaty. Peru argued, for instance, that Kaloti's alleged purchase of the Shipments was a mere commercial transaction, and that neither that purchase nor Kaloti's operations in Peru possessed the requisite characteristics of an "investment" for purposes of the Treaty and the ICSID Convention. Peru pointed out that, in any event, Kaloti had been unable to prove that it ever acquired ownership over the Shipments. Peru also argued that, even if Kaloti had indeed acquired ownership at some point, it would have done so in violation of Peruvian law and international public policy. In addition, Peru argued that nearly all of Kaloti's claims were time-barred, as they had been filed in breach of the three-year temporal limitation set out in Article 10.18 of the Treaty.

On the merits, Peru argued that none of the Challenged Measures were contrary to Peru's obligations under the Treaty. Such measures had been adopted reasonably and justifiably in order to combat illegal mining and money laundering, which is undeniably a legitimate public policy objective. Peru also demonstrated that Kaloti had failed to comply with its obligation to conduct a reasonable due diligence, and instead ignored garish red flags that would have indicated to any responsible company that the gold had been illegally mined. On the basis of these and other arguments, Peru posited that Kaloti's claims were utterly and wholly meritless and should be rejected.

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[3] *See*, *e.g.*, "*EY ordered to pay $10m to Dubai whistleblower*," FINANCIAL TIMES, 17 April 2020; "*EY ordered to pay whistleblower $11m in Dubai gold audit case*," THE GUARDIAN, 17 April 2020; City of Gold: Why Dubai's First Conflict Gold Audit Never Saw the Light of Day, GLOBAL WITNESS, February 2014; Beneath the Shine: A Tale of Two Gold Refiners, GLOBAL WITNESS, July 2020, pp. 16–18; *Amjad Rihan v. Ernst & Young Global Ltd.*, *et al*., Case No. 2020 EWHC 901 (QB), Judgment, 17 April 2020, ¶¶ 3, 4, 103, 118-122, 605; "*EY whistleblower awarded $11 million after suppression of gold audit*," REUTERS, 17 April 2020; "*EY accountancy firm accused of facilitating money laundering by drug traffickers,*" EU-OCS, 30 October 2019.

The Award

Ultimately, the Tribunal agreed with Peru, finding that Kaloti had failed to establish that it had a covered investment in Peru for purposes of the Treaty. Specifically, the Tribunal found that Kaloti had failed to establish that it had "ownership or possession of the gold in the five shipments and thus, it ha[d] been unable to establish that the gold in those shipments on their own constituted an asset that could be an investment by [Kaloti] in Peru."

Likewise, the Tribunal concluded that Kaloti had failed to establish that "it had a business in Peru, separate from its Miami based operation, that could constitute an investment" under the Treaty. In that respect, the Tribunal held that the existence of an investment cannot be established simply by showing that an asset possesses *one* characteristic of an investment. Rather, the Tribunal agreed with Peru that the Treaty requires claimants to prove that they own or control an asset that has *all* the "characteristics" of an investment. In that respect, the Tribunal explained that, to establish the existence of an investment under the Treaty, a claimant must show: (i) that "there is a commitment of capital that is "'substantial';" (ii) "certain duration of the investment" involving "a long-term commitment to operating and creating value" in the host State; (iii) "[a]n expectation of gain or profit;" (iv) an assumption of "investment risk" that goes beyond the "risks inherent in any commercial operation;" and (v) arguably, a "contribut[ion] to the economic development of the host state."

Kaloti failed to establish that its alleged investments in Peru possessed these characteristics. The Tribunal concluded, for instance, that there was "no substantial commitment of capital or other resources to an investment in a going concern business enterprise in Peru." It also concluded that there was no evidence of an actual business enterprise "that involve[d] a long-term commitment to operating and creating value in Peru," nor any evidence of "an investment of a long-term duration rather than an operation to support Kaloti's purchase and sale of gold, an operation based in Miami." Concerning assumption of risk, the Tribunal held that "[i]nvestment risk is about the uncertainty of how much will have to be put into the investment and the uncertainty over what the return may be," and affirmed that "[a] commercial transaction is not an investment." In that respect, the Tribunal held that "risks involved in sourcing gold and the possibility of losing that gold would be common to all gold trading operations regardless of whether the gold trader had an investment in Peru."

The Tribunal concluded that, in the absence of evidence to support Kaloti's claim that it had an investment in Peru, "there was no reasonable basis for litigating this claim." For that reason, the Tribunal ordered Kaloti to reimburse Peru for 100% of its arbitration costs, including the totality of the legal fees that the State incurred in the arbitration. Notably, during the Arbitration, Peru had submitted an application for security for costs. Following the Tribunal's decision on that application, Kaloti's shareholders issued an undertaking committing to pay any final order on costs.

Recently, Arnold & Porter secured another positive outcome in a security for costs application filed on behalf of its client the Republic of Costa Rica in the case of *José Alejandro Hernández Contreras v. Republic of Costa Rica* (ICSID Case No. ARB(AF)/22/5). The Tribunal in that case ordered claimant to provide a guarantee for USD 1.2 million.

The Arnold & Porter team in the *Kaloti* case was led by partners Patricio Grané Labat and Paolo Di Rosa, and included counsel Álvaro Nistal, associates Tim Smyth, Katelyn Horne, Andrea Mauri, Paloma García Guerra, and Ana Pirnia, as well as foreign associate Agustín Hubner. Partner Mélida Hodgson assisted with oral argument at the hearing.