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REFLECTION OF PRE-INVESTMENT EXPENDITURE IN DEFINITION OF BILATERAL INVESTMENT TREATIES: A CHANGING LANDSCAPE

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ABSTRACT

All foreign investments come with certain pre-investment expenses, but the legality of such expenses under investment law still largely remains untouched. Can a foreign investor who has invested a significant sum of money in negotiations and followed all legal procedures to obtain a valid permit to proceed with a foreign investment project later be awarded damages under a particular bilateral investment treaty if the government rejects the project citing the government's actions as a breach of the treaty? Neither Article 25 of the International Centre for Settlement of Investment Disputes (hereafter ICSID) nor the bilateral investment treaties (hereafter BITs) often explicitly address or describe the legal status of this pre-investment expenditure. Clearly defining the legal status of pre-investment expenses is crucial for providing clarity, predictability, and risk mitigation for investors, ensuring their protection. Can those expenses incurred by the foreign investor be interpreted within the meaning of 'investment'? The first section of the paper seeks to explore the scope of Article 25 of the ICSID Convention, which is significant in deciding the jurisdiction of the ICSID. The definition of an investment, as stated in investment treaties, is discussed in the second section focusing more on first-generation BITs. The third section is devoted to addressing

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the Mihaly case, which is the first ISDS case that involves determining whether the pre-expenditure cost may be seen as an investment. The fourth section reflects the trends in investor-state arbitration, the new generation BITs that have arisen since the Mihaly case and their implication on both the host state and investor, followed by the overall conclusion.

Key Words: Investment, Pre-investment Expenses, First-Generation BITs, Article 25 of the ICSID Convention, Mihaly case, New Generation BITs.

INTRODUCTION

Expenses incurred to make an investment are usually referred to as pre-investment or pre-contract costs.[1] Salacuse views *the cost an investor bears during the development of a project that is never completed as the pre-investment cost*.[2] Pre-investment costs could include, but are not limited to, those associated with financing, negotiating, engineering, environmental, legal, and financial advising work.[3] For a financial expert, this may amount to an investment because this is a commitment of funds to a business in expectation of return.[4] The first-generation BITs have no reference or a clear indication of pre-investment expenditure as they are primarily intended to protect established investments. However, there needs to be more clarity in international investment law as to whether pre-investment expenditure constitutes an investment. The significance of determining the meaning and content of pre-investment expenditure directly affects the jurisdiction and merits of an investment dispute. Determining the jurisdiction (jurisdiction, *ratione materiae*) of investment treaty arbitration begins with defining what an investment is.[5] It delves into identifying the subject matter of the investment defining the content of rights and obligations under the investment treaty.

Since the term investment is a complex operation composed of various interrelated transactions, it differs from the nature of property and property rights and interests *per se*. In practice, two conceptual

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[1] Dr. Willcocks Andrew, *Pre-Investment Expenditure*, JUS MUNDI, (Feb. 1, 2024, 09:00AM), *https://jusmundi.com/en/document/publication/en-pre-investment-expenditure*.

[2] JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES 197 (3rd edn., 2021).

[3] *Supra Note No.* no. 2.

[4] *Supra Note No.* no. 2, p. 197.

[5] CAMPBELL MCLACHLAN, LAURENCE SHORE & AND MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 218 and 225 (2nd Edn., 2017).

approaches have been developed to define the meaning of investment: one is understanding the scope of Article 25 of the ICSID Convention developed through arbitral jurisprudence, and the other is understanding the specific meaning given in the operative part of the BIT.[6] The definition given for the investment is a key element in the operative part of any BIT that provides the details of the specific obligations of the contracting states and the protections given to investors, thereby influencing the legal and regulatory framework for international investment. These two approaches are also known as the double keyhole test, and both tests have to be fulfilled to satisfy the subject matter jurisdiction.[7] These two tests are complimentary to each other as they both purpose to promote foreign investment. Even though the ICSID provisions are applicable only for ICSID arbitrations, various rulings, as well as multiple writings, have pointed out that Article 25 of the ICSID applies to all other instruments defining what an investment is.[8] However, neither Article 25 of the ICSID nor the BITs often explicitly addresses or describes the legal status of pre-investment expenditure. Against this backdrop, if a foreign investor spent a large amount of money on the negotiation and followed the due procedure to obtaining a valid legal permit to proceed with the foreign investment project and later if the government rejects the project, can they claim damages under the specific BIT considering the act of the government as a violation of treaty provision? Can those expenses incurred by the foreign investor be interpreted within the meaning of 'investment'? This paper aims to delve into those issues. Providing protection to the established investment by the host state is the basic notion of foreign investment law. However, the question here is whether this protection extends to the expenses incurred under pre-establishment. The first section of the paper seeks to explore the meaning of Article 25 of the ICSID Convention. The second section deliberates how the investment treaties define foreign investment. The *Mihaly* case is the first ISDS case that involved deciding whether the pre-expenditure cost can be contemplated as an investment, and the third section is devoted to

[6] Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law 60-61 (Oxford University Press 2008).

[7] *Malicorp vs Egypt*, (Award) I CSID Case No ARB/08/ l 8, para 107.

[8] *Ibid*, p. 218.

discussing this case. The final section reflects the developments that emerged after the *Mihaly* case in both investor-state arbitration and recent BITs focusing on their implication to host state and investor and finally followed by the conclusion.

ARTICLE 25 OF THE ICSID CONVENTION

According to Article 25 (1) of the ICSID Convention, the subject matter jurisdiction extends to *"any legal dispute arising directly out of an investment"* (emphasis added). No definition is offered to identify what an investment means. Nonetheless, the definition of investment is crucial in striking an appropriate balance between the interests of the host state and the interests of the investors.[9]

Christoph H. Schreuer has enumerated various economic activity as investment as follows,

> ... the building and operation of hotels, the production of fibers and textiles, the mining of minerals; the construction of a hospital ward, the exploration, exploitation and distribution of petroleum products, the manufacture of plastic bottles, the construction and operation of a fertilizer factory, the construction of housing units, the operation of a cotton mill, aluminium smelter, forestry, the conversion, equipping and operation of fishing vessels, the production of weapons, tourism resort projects, maritime transport of minerals, a synthetic fuels project, shrimp farming, banking, agricultural activities, the construction of a cable TV system and the provision of loans"[10]

Although Article 25(1) describes the coverage and extent of the subject matter jurisdiction of the ICSID, the drafting history of the ICSID Convention evidences that drafters were unable to have unanimity about the definition of investment. The drafters of the ICSID Convention

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[9] Rudolf Dolzer, Ursula Kriebaum & and Christoph Schreuer, Principles of International Investment Law (3rd edn. 2022).

[10] Christoph H. Schreuer et al., The ICSID Convention: A Commentary: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States 138 (119) (2001).

intentionally left, providing a definition for the term investment. Otherwise, it may either arbitrarily limit the scope of the Convention, or it would be too broad to serve the purpose of the Convention, putting either the host state or the investor in a more disadvantageous position.[11] Some commentators were of the view that the non-availability of the definition of investment gives more latitude to the host states to define the meaning and the content of the term investment, thus being overly proactive to the interests of the host state.[12] On the other hand, the Tribunals believe that the silence of Article 25 on the definition of investment was intended to leave a certain amount of room for the parties to develop the concept of investment further.[13] This contention is further supported by Article 25 (4) of the ICSID Convention, as it allows the contracting states to determine the class or classes of dispute that they will consider submitting to the jurisdiction of the Centre. However, since the ICSID Convention has not provided more clarity regarding the meaning of investment, tribunals have eventually determined what an investment is within a broad discretionary range based on the Treaty between parties.

For instance, the agreement to build a highway in Morocco gave rise to the conflict in the *Salini* v. *Morocco* case.[14] Morocco objected to jurisdiction when a dispute under the Italy-Morocco BIT emerged, arguing that the transaction in question should be classified as a contract for services rather than an investment contract thus not covered under the given definition under the BIT. The Tribunal specified the following requirements and later named them and followed them[15] as *Salini* criteria.

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[11] The History of the ICSID Convention, ICSID (Mar. 9, 2023, 09:00 AM), *https://icsid.worldbank.org/resources/publications/the-history-of-the-icsid-conventio*; *Transcript of Meeting of the Executive Directors of the IBRD, held on Tuesday, December 15, 1964 (English)*. Board transcript Washington, D.C.: World Bank Group, *http://documents.worldbank.org/curated/en/257911580881734189/Transcript-of-Meeting-of-the-Executive-Directors-of-the-IBRD-held-on-Tuesday-December-15-1964*.

[12] Martin Hunter, *Reflections on the Definition of an Investment*, 380 Global Reflections on International Law, Commerce and Dispute Resolution: Liber Amicorum in honour of Robert Briner 385 (Anne Marie Whitesell ed., 2005).

[13] *Abaclat vs. Argentina*, Decision on Jurisdiction, 4 August 2011, para 347.

[14] *Salini vs Morocco* (Decision on Jurisdiction) 23 July 2001,para 56.

[15] *Ceskoslouenska Obchodni Banka AS vs Slovakia* (Decision on Jurisdiction) ICSID Case No ARB/97/4 ICSID Rep 330, IIC 49; Joy Mining Machinery Ltd v Egypt (Award) ICSID Case No ARB/03/11.

> 'The doctrine generally considers that investment infers contributions, a certain duration of performance of the contract, and participation in the risks of the transactions. In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.'[16]

The Tribunal viewed infrastructure projects, such as highways, as contributing to a country's economic growth and development, thereby meeting the criterion of contribution to the economy of the host state to count such activity within the meaning of an investment. However, subsequent tribunals found this requirement as controversial. Notably, the Annulment Committee in *Malaysian Historical Salvors v Malaysia* criticized the *Salini* test as imposing 'outer limits' on Article 25 of the ICSID Convention that did not appear in the *travaux preparatoires* and defined the meaning of investment as

> 'The commitment of money or other assets for the purpose of providing a return. In its context and in accordance with the object and purpose of the treaty [ICSID Convention]-which is to promote the flow of private investment to contracting countries by provision of a mechanism which, by enabling international settlements of disputes, conduces to the security of such investment-the term 'investment' is unqualified conclusions on the question as to whether a ship salvage contract was an investment.'[17]

Hence, the Tribunal found that a ship salvage contract was as an investment. Similarly, in the *Biwater v Tanzania* case, the Tribunal explained the *Salini* test as problematic and viewed that '[I]f very substantial numbers of BITs across the world express the definition of 'investment' more broadly than the *Salini* Test, and if this constitutes any type of international consensus, it is difficult to see why the ICSID Convention ought to be read more narrowly.' However, there is no

[16] *Supra Note No.* no. 11, para 52.
[17] *Malaysian Historical Salvors Sdn Bhd vs Malaysia* (Decision on Annulment) ICSID Case No ARB/05/l 0, para 57.

unanimity in the criteria to be followed in defining the investment. If the threshold of the definition of investment is high it is likely to be beneficial for the host state as treaty protection is accorded only to the investments covered under the Treaty. As discussed above, the evolving case law has also had a significant influence on shaping the meaning of an investment. Because of the active role played by the arbitrators in defining the meaning of an investment, Dollzer, and Schreuer view this as a self-contained approach.[18]

Notably, Article 25 does not make any explicit reference as to whether pre-investment expenditure creates an investment. The next section elaborates on the second criterion to decide the meaning of an investment, i.e., the definition given in the BIT.

DEFINITION OF INVESTMENT IN BITS

While satisfying the meaning of investment, the Tribunal generally considers the definition given in the BIT in consonance with Article 25 of the ICSID Convention. The Tribunal in *Lemire v Ukraine* suggested that 'where the ICSID Convention is open to interpretation, such interpretation should seek compatibility rather than contradiction with the relevant treaty provision.'[19] All the BITs generally include the same method for the definition of investment. The formula begins with an all-inclusive general statement and proceeds to describe roughly five distinct categories of rights. For instance, India-Nepal BIT of 2011 states that,

> "investment" means every kind of asset established or acquired, including changes in the form of such investment, by an investor of one Contracting Party in accordance with the laws of the other Contracting Party in the territory of the latter and in particular, though not exclusively,
>
> includes (i) movable and immovable property as well as other rights related thereto such as mortgages, liens or pledges;
>
> (ii) shares in and stock and debentures of a company and any other similar forms of participation in a company;

[18] Interpretation outside the understanding for the drafters of the ICSID Convention.
[19] *Lemire vs Ukraine (*Decision on Jurisdiction and Liability) ICSID Case No ARB/06/18, para 93.

(iii) claims to money or to any performance under contract having a financial value;
(iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party;
(v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals[20]

While Nepal -India BIT was terminated in 2017, the Treaty is applicable for another ten years for already established investments in both states before the termination. This approach followed in the above BIT could be seen as the party-driven approach, as the definition given on investment in the operative part of the particular Treaty is decided by the contracting parties. However, this method is not free from ambiguity. A similar approach is reflected in other BITs starting from the first BIT of Germany and Pakistan to BITs concluded in the 1990s as well. This typical method of defining an investment incorporates a broad asset-based definition with a non-exhaustive list.[21] This may provide a wide range of protection to the economic activities of investors, sometimes even making pre-investment expenditure an investment.

MIHALY V SRI LANKA

The *Mihaly vs. Sri Lanka* case[22] is the first arbitral ruling to determine whether pre-investment expenditures count as investments. This is the second investor-state arbitral case involving Sri Lanka.[23] In this case, the Claimant sought damages for a project that never materialized but incurred some expenses in the establishment phase.

Facts of the Case and Arguments by the Parties

The Mihaly International Corporation, a USA Cooperation, made this submission to the ICSID in July, 29th 1999 against the Government

[20] Agreement between the Government of India and the Government of Nepal for the Promotion and Protection of Investments (date of signature 21/10/2011, date of termination 22/03/2017).
[21] Prabhash Ranjan, *Definition of Investment in Bilateral Investment Treaties of South Asian Countries and Regulatory Discretion*, 26 JOURNAL OF INTERNATIONAL ARBITRATION (2009), (Sep. 11, 2023, 09:00AM), *https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\JOIA\JOIA2009011.pdf*
[22] *Mihaly International Corporation vs. Democratic Socialist Republic of Sri Lanka.* (ICSID Case No ARB/00/2).
[23] *Asian Agricultural Products Limited vs. Sri Lanka* (ICSID Case No ARB/ 87/3).

of Sri Lanka(hereinafter GOSL) under the ICSID Convention invoking Treaty between the United States of America and Sri Lanka concerning Encouragement and Reciprocal Protection of Investment (hereinafter the US - Sri Lanka BIT).[24] The reason for making the claim was to reimburse the expenses incurred to prepare financial and technical documentation, to undertake technical and commercial studies, and to participate in the tender procedure in the more credible manner by Mihaly Canada pursuing the proposed power plant project of 300 megawatts which intended under built, operate and transfer agreement (hereinafter BOT).[25] In 1992, the GOSL called for expressions of interest to establish new power generation facilities through private enterprises on a BOT basis to strengthen the electricity supply of Sri Lanka. The claimant is a consortium of international investors who had expressed its interest in setting up a power plant, and initially, 25 groups have expressed their interest in the project, of which only five were invited to enter into negotiations.[26] Among those 5, the claimant was selected as the recipient of the letter of interest (hereinafter LOI) dated 15 February 1993.[27]

On 22 September 1993, the letter of Agreement (hereinafter LOA) was executed, and subject to the contract, the parties reached some understanding, including taking or paying the obligation of 70 percent of the capacity of the plant.[28] It intended to distribute the electricity supply in Sri Lanka through the South Asia Electricity Company. On 20 July 1994, the parties entered into the Letter of Extension (hereinafter LOE) extending the exclusivity granted to the claimant on negotiations and stated that if the claimant failed to achieve any of the milestones by the due date, the Letter of Extension ceases to be operative.[29] However, since the GOSL has rejected signing the BOT Agreement, the Mihaly Cooperation has sought to claim for already incurred expenditure for the project never materialized in violation of the protection granted under US-Sri Lanka BIT.

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[24] *Supra* Note No. 23, para 1.
[25] *Supra* Note No. 23, para 39.
[26] *Supra* Note No. 23, para 39.
[27] *Supra* Note No. 23.
[28] *Supra* Note No. 23, para 44.
[29] *Supra* Note No. 23, para 46.

Since the Respondent GOSL contended the jurisdiction of ICSID from the first session, the Tribunal had first to determine whether the Tribunal satisfied the jurisdiction *ratione personae* (personal jurisdiction) and *ratione materiae* (subject matter jurisdiction) to hear the matter.

The claimant, the Mihaly International Corporation, particularly alleged that in pursuance of Article VI(1) (C) of US-Sri Lanka BIT, rights conferred with respect to an 'investment' has been breached and in pursuance to Article II(2) of US- Sri Lanka BIT, the protection accorded under fair and equitable treatment, full protection and security has been breached by the respondent and claim the damages for incurred expenditure. Nonetheless, the Respondent government denied all purported violations submitted by the claimant and rejected the jurisdiction of the Tribunal. The Respondent refused the jurisdiction *ratione personae* and contended that Mihaly Canada, who is the actual claimant of this case, cannot assign the claim to Mihaly USA without having the consent of Sri Lanka.[30] It rejected the argument on partnership due to lack of evidence and argument of theory of assignment due to lack of consent of Sri Lanka.[31] As Canada is not a party to the ICSID convention, Sri Lanka was of the view that the claim should be dismissed.

The most crucial argument was made relating to jurisdiction *ratione materiae*. The respondent was of the view that if there is no proof of an investment under Article 25(1) of the ICSID Convention, there can be no dispute for the ICSID to decide upon.[32] The Claimant relied on the expert opinion of Mr Per Ljung and claimed that the expenditures during the development phase are essential for the successful operation of the BOT investment project and thus constitute an investment cost.[33] The claimant supported having a broad interpretation of the term investment as it encourages the free flow of capital into developing countries. Although the respondent accepted the possibility of including developmental expenditure in investment cost, the government believed

[30] *Supra* Note No. 23, para 16-17.
[31] *Supra* Note No. 23.
[32] *Supra* Note No. 23, para 28.
[33] *Supra* Note No. 23, para 34.

there was no agreement between the parties to admit the investment in question.[34] On the other hand, in the absence of such explicit consent between the parties, no broad interpretation can be given to the term investment to include pre-establishment expenditure.[35]

The claimant relied on the LOI, the LOA, and the LOE as evidence of agreement on the part of Sri Lanka for the claimant to invest in the proposed project. With these documents, the claimant argues that they converted the project into an investment as it displayed the interest of the Respondent in the claimant to proceed with the project.[36] However, the Respondent rejected the argument of LOI and stated that the contract was never finalized and, importantly, it specified that "this Letter of Intent constitutes a Statement of Intention and does not constitute an obligation binding on any party," meaning that it has not created any binding obligation between the parties.[37] Further, it indicated that the project and the contract details are subject to the Cabinet's approval of Sri Lanka. Similarly, according to the Respondent, the LOA was also not conclusive as it is conditional upon the approval of CEB to contract with South Asia Electricity Company(hereafter SAEC) and all other associated agreements and it explicitly recognized that it does not create any contractual obligation between the parties.[38] The LOE also included the same clause and contended that it did not constitute any binding obligation on any party.[39] Based on these arguments, the Respondent rejected the jurisdiction of the tribunal.

Summary of the Award

Determining the case based on the ICSID Convention and rules of International Law, the Tribunal first decided the competency of the Tribunal to hear the matter. The Tribunal first examined the jurisdiction *ratione personae*. The Tribunal held that Mihaly Cooperation has jurisdiction *ratione personae* and the Mihaly USA was entitled to bring a

[34] *Supra* Note No. 23, para 35.
[35] *Supra* Note No. 23, para 36.
[36] *Supra* Note No. 23, para 36.
[37] *Supra* Note No. 23, para 38.
[38] *Supra* Note No. 23, para 45.
[39] *Supra* Note No. 23, para 46.

claim in its name against Sri Lanka as they are a part of an international consortium.[40] However, this does not *per se* create the jurisdiction and jurisdiction *ratione materiae* must also be satisfied for the ICSID to hear the matter.

The reasoning given relating to *ratione materiae* has made the case more remarkable as it addressed the relevancy of pre-investment cost in defining the investment for the first time in the history of investment treaty arbitration. The Tribunal carefully viewed that in contemporary commercial relations, a huge amount of expenses has to be incurred to prepare an activity to a final contract and it is for the parties to determine at which stage their project becomes an investment and it is not determinant on the amount of the money that they are spend on.[41] Nonetheless, the Tribunal observed that the operation of the SAEC was contingent on the execution of the contract, and the expenditure made by the claimant would only be regarded as an investment once it was approved by the GOSL.[42] The Tribunal concluded that LOI, LOA, and LOE did not contain any binding obligation on either party, and expenditure incurred by the host state does not constitute an investment within the sense of the Convention.[43] On the other hand, the definition given on investment in US-SL BIT admits the rights of the parties to decide a definition of investment, and when there is no agreed investment between the parties, the Tribunal decided that it does not have jurisdiction to entertain the matter.[44]

In this background, the Tribunal decided it does not satisfy the jurisdiction *ratione materiae* to proceed with the case.[45] In the absence of any proof of admission of an investment, the case was dismissed as the Tribunal is without the jurisdiction to entertain the matter. When there is no jurisdiction, it becomes premature to determine whether the proposed project qualifies for fair and equitable treatment and full protection and security.

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[40] *Supra* Note No. 23, para 23.
[41] *Supra* Note No. 23, para 51.
[42] *Supra* Note No. 23.
[43] *Supra* Note No. 23, para 59.
[44] *Supra* Note No. 23,para 52.
[45] *Supra* Note No. 23,para 62.

However, David Suratgar, in his concurrent opinion, viewed that when the investor had already spent a huge amount of in the pre-investment phase, there should be a protective mechanism to recover such expenses money; otherwise, the interests of the prospective investors would be detrimental.[46] Supporting this argument, one scholar has stipulated that a new category of disputes for the ICSID has to be introduced as 'pre-investment disputes' to encourage the participation of developed countries in the investment of developing countries.[47] The drafting history of the ICISID, together with the definition given on investment in the USA- Sri Lanka BIT particularly, appears in favor of the party-driven approach. Article 01 of the USA-Sri Lanka BIT does not explicitly incorporate pre-establishment charges within the meaning of an investment, thus giving the plain, textual meaning to the USA-Sri Lanka BIT,[48] rights which are not conferred by the contract were not conceived as an investment.

POST- MIHALY DEVELOPMENTS

Outstandingly, the Mihaly Tribunal is the first to decide the relevancy of pre-investment expenses in defining the investment, and this award has later given precedent to other Tribunals to oust such expenses within the purview of ICSID. Deciding the jurisdiction in the *Mihaly* case, the author argues that if the parties have not expressly agreed to include the pre-investment cost within the definition of an investment, there is no investment, meaning there can be no legal dispute. This reasoning inspired later Tribunals, including *RSM Production Corporation vs. Grenada*,[49] *Mytilineos Holdings SA v. Republic of Serbia*[50] and *Zhinvali v Georgia*.[51] For instance, the claimant in the *Zhinvali case* was not included in a project for the rehabilitation of a hydroelectricity plant after three years of discussions. The Tribunal refused jurisdiction on the

[46] *Supra* Note No. 23.

[47] Robert N Hornick, The Mihaly Arbitration Pre-Investment Expenditure as a Basis for ICSID Jurisdiction, 189 Journal of International Arbitration 193(2003).

[48] Article 31(1) of Vienna Convention on the Law of Treaties, 1969 (United Nations, Treaty Series, 1155).

[49] *RSM Production Corporation vs. Grenada,* (ICSID Case No. ARB/05/14).

[50] *Mytilineos Holdings SA* vs. *Republic of Serbia* ,UNCITRAL, Partial Award on Jurisdiction 126 (8 September 2006).

[51] *Zhinvali Development Ltd. vs. Republic of Georgia* (ICSID Case No. ARB/00/1).

basis that pre-investment spending did not meet the requirements of the 1996 Georgian Investment Law. Hornick strongly supports the Tribunal's ruling in *Mihaly.* As Hornick remarks, there would be many bidders in any pre-investment procedure, and only one out of them could win. A large number of disputants would arise if treaty claims pertaining to pre-investment disputes could be made. Furthermore, a national court applying domestic criminal law would be a better forum to consider the matters involving pre-investment expenditure if the dispute involves bribery and corruption. Particularly, In *CSOB V Slovakia*,[52] it was held that a standalone transaction of the investor would not qualify as an investment under the ICSID, provided that the particular transaction forms an integral part of an overall operation to qualify as an investment.[53] *Mihaly* Tribunal went far to highlight options available for the investor, and in an *obiter dictum*, it noted that even in the absence of any contractual obligations during lengthy negotiations, the host state may have an obligation to act in good faith.[54] It was pointed out that though such a breach of obligations is outside the mandate of the ICSID Convention, such investors are entitled to damages or some other remedy. If pre-investment expenditure cases entail delicate bribery and corruption concerns involving the host state, they are best assessed by national courts following domestic law.[55]

Conversely, in the case of *PSEG v. Turkey*,[56] the involved parties executed a concession agreement for a power plant; nevertheless, the project was never completed. Due to the fact that the project was never materialized and the contract still lacked key clauses, the respondent claimed there was no investment.[57] However, the Tribunal accepted the legal validity of the concession agreement as it had duly signed, approved and duly followed the legal formalities. It was held that,

> 'An investment can take many forms before actually reaching the construction stage, including most notably the cost of

[52] *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*. (ICSID Case No. ARB/97/4)
[53] *Supra Note No.57,* Para 72; *'Enron Corporation and Ponderosa Assets, L.P. vs. Argentine Republic (*ICSID Case No. ARB/01/3) para 70.
[54] *Supra* Note No. 23, para 51.
[55] *Supra* Note No. 23.
[56] *PSEG vs. Turkey,* (Decision on Jurisdiction) 4 June 2004, paras. 66–73.
[57] *Supra* Note no. 23, para 79–104.

> negotiations and other preparatory work leading to the materialization of the Project, even in connection with pre-investment expenditures, particularly when, like in this case, there is a valid and binding Contract duly executed between the parties.'[58]

Development expenses might end up being covered by the total investment if the project is successful.[59] The signing of a legally binding contract is the crucial point at which a project shifts from preparation to actual investment.[60]

In the case of *Bear Creek Mining v. Peru*,[61] the claimant had seven mining concessions as well as authorization to purchase and possess mining rights. Following demonstrations by local communities, these rights were taken away by the government. The Respondent contended in the arbitration that because the necessary permits were still pending, the Claimant's rights and actions had never matured into an investment. The claimant cited the unity of investment in its several phases and activities. The Tribunal adopted the Claimant's strategy and declared that,

> Indeed, it is uncontroversial that an investment typically consists of several interrelated economic activities which, step by step, finally lead to the implementation of a project such as mining activity. As Claimant points out, the steps already obtained and completed were (1) the finding of public necessity that expressly authorized Claimant to acquire mining rights in the border region, (2) Claimant's acquisition of mining concessions comprising the Santa Ana Project and the Corani Project, (3) the years Claimant engaged in expensive exploration and development efforts in Respondent State, and that these efforts (4) apparently resulted in the discovery of significant economic silver mineralization in the area.[62]

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[58] *Supra* Note No. 61 (Award, 19 January 2007) para. 304.
[59] SCHREUER ET AL., *Supra* Note no. 13, pp. 135 and 136.
[60] SCHREUER ET AL., *Supra* Note no. 13.
[61] *Bear Creek Mining Corporation* vs. *Republic of Peru*, ICSID Case No. ARB/14/21, Award (30 November 2017).
[62] *Supra* Note no. 66, para 296.

Hence, the tribunal determined that there was an investment. When there is no 'substantive commitments and arrangements ... involving specific commitments and financial costs', the Tribunal in *Eyre and Montrose v Sri Lanka*[63] decided that there was no investment. However, since there is no judicial precedence requirement in investment treaty arbitration, the Tribunals are free to determine cases on a case-by-case basis, either following or not following *Mihaly'*s case in a case involving pre-establishment rights. When the states made reformations to the traditional BITs, considering their adverse effects on protecting the interests of the host state, the broad asset-based definition of investment has changed into an enterprise-based definition where an enterprise is taken together with its assets.[64]

In fact, new-generation investment treaties have gone beyond the traditional first-generation model BIT and arbitral practices and attempted to bring more precision to the Treaty by providing a more sophisticated definition for the investment. Application of National Treatment (hereafter NT) provisions for the pre-establishment phase of the investment is found in regional trade agreements such as the North American Free Trade Agreement (hereafter NAFTA) with country-specific exceptions.[65] These measures limit the capacity of the host state to discriminate in the acceptance of foreign investments. New generation BITs contain a closed (or exhaustive) list of investment forms limiting the subject matter of the jurisdiction.[66] The specified list of covered assets clearly identifies which assets are protected under the treaty.

This state practice is very well reflected in the Indian Model BIT. The India's Model BIT of 2016 has interpreted the pre-investment activity as follows,

> 'The term "Pre-investment activity" includes any activities undertaken by the investor or its enterprise prior to the

[63] *Raymond Charles Eyre and Montrose Developments (Private) Limited vs. Democratic Socialist Republic of Sri Lanka,* (Award, 5 March 2020) ICSID Case No. ARB/16/25, paras 301, 303.

[64] 1.4 of Model Text for the Indian Bilateral Investment Treaty, 2016,

[65] Article 1101-1103 of *the North American Free Trade Agreement (*NAFTA), *1994.*

[66] Oskar Rydermark, *Interpreting the Term 'Investment' in International Investment Law by Subsequent Agreements*, (2020), (Feb 2, 2024, 07:30 AM), *https://urn.kb.se/resolve?urn=urn:nbn:se:uu:diva-405866.*

> establishment of the investment in accordance with the law of the Party where the investment is made. Any activity undertaken by the investor or its investment pursuant to compliance with sectoral limitations on foreign equity, and other limits and conditions applicable under any law relating to the admission of investments in the Party where the investment is made in specific sectors falls within the meaning of "Pre-investment activity.'[67]

Indian Model BIT of 2016 has moved a step further and stipulated that any pre-investment activity related to the establishment, acquisition, or expansion of any investment or to any measure pertaining to such pre-investment activities shall not be covered under the provisions of the Treaty.[68] Since the Treaty has explicitly excluded pre-investment expenditure from investment, this approach followed in the new investment treaties regulates the expectations of the investors on one hand and the obligations of the host state on the other. Even the *Mihaly* Tribunal, in an obiter dictum, viewed that the future law (*de lege ferenda*) of BIT has to be extended to define the meaning of an investment, specifying whether pre-investment cost could be considered as an investment.[69] Conversely, if the parties to an investment treaty are consented to include pre-investment activities within the domain of the treaty, they can be explicitly included.[70] This approach provides more certainty and predictability to the parties involved in the foreign investment.

CONCLUSION

If the pre-establishment rights of the investors are protected, it means that treaty protection is accorded to the investors throughout the phase of the attempt to establish or make an investment in the host nation. Since the first generation of BITs did not include the legal status of pre-establishment expenditure, investor-state arbitration rulings were the ones to decide the legality of pre-establishment rights under international

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[67] 1.11 of Indian Model BIT.
[68] Article 2.2 of Indian Model BIT.
[69] *Supra* Note No. 23, para 60.
[70] Article 11.28 of the *United States-Korea Free Trade Agreement* (KORUS FTA), 2019.

investment law. *Mihaly International v Sri Lanka* is the first ISDS case to decide on this. The Tribunal determined that the pre-investment expenditure fell outside the definition of investment in the BIT. Since both Mihaly Corporation and GOSL have consented from the beginning that the power plant establishment contract would be entered subsequently with the cabinet's approval, the unilateral characterization of certain expenses by the Claimant in preparation for an investment was decided as inadequate to qualify as an investment. None of the documents exchanged between Mihaly Corporation and the government did not create any binding legal obligation.

The discretion given to the arbitrators in this claim has been judiciously exercised to decide the case, respecting the party-driven approach. Pre-investment expenses are a part of the ordinary business risks that foreign investors undertake. However, the inconsistent decisions and judicial activism in investor-treaty arbitration have influenced the States to incorporate explicit provisions in determining the rights and duties of the investor, as well as the regulatory space of the host state. While providing such reference, investment treaty provisions themselves place restrictions on the degree of protection and liberalization that a pre-establishment phase is offered in the host state. The new generation treaties trend includes incorporating a positive and negative list in this regard not only to bring certainty to the Treaty but also to limit arbitrators' discretion. Excluding pre-investment expenditures from BIT protection can result in decreased investor confidence, increased risk, reduced FDI, slower economic development, and potential legal ambiguities. Host countries may find it more difficult to attract and retain foreign investments, particularly in the early stages of investment projects. On the other hand, recognizing pre-investment expenditure within BIT protection may increase the likelihood of having more ISDS claims, and the host state may have more obligations towards the investors. Ultimately, it is up to the contracting states to decide whether to undertake the risk and obligation associated with pre-investment expenditure at the time of negotiating the investment treaty.

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