Kluwer Arbitration Blog

Pre-contractual liability- Another look needed: F-W Oil Interests, Inc. v. Republic of Trinidad and Tobago, ICSID Case No. ARB/01/14

Abhijit Pandya (The London School of Economics and Political Science) · Tuesday, March 2nd, 2010

It is not easy to get a grip on the vast amount of case-law being churned out by investment treaty arbitration panels. However, if law students wanted examples of the ultimate slap-dash arguments being put together by claimant lawyers, then go no further than to sample some of arguments launched in this case. It is important enough to warrant a timely re-appraisal. In the case of FW Oil Interests, a distinguished tribunal (comprised of Sir Franklin Berman and Lord Mustill), subtly warn of lazy broad arguments where the credibility of Government officials is questioned with foundationless allegations of corruption. (The tribunal in the recent EDF case (ICSID Case No. ARB/05/13) tried to cut down the law of corruption to at least relate 'fault' to evidential basis). If one were to approach litigation in the English Bar in similar vein, serious disciplinary action would no doubt ensue. The worrying aspect is that in not exercising their discretion appropriately in tailoring claims lawyers are undermining the long-term viability of the system and weakening its credibility. This approach is partial result of the endemic conflict in the system between a correct approach founded in public international law and, the more popular of, reducing the sovereign state to a mere private entity in commercial arbitration governed by private law.

The claim itself was based on losses that the supposed investor had suffered through pre-contractual expenditure, prior to acquiring a bid and forming a contract. The tribunal rejected the claim on the basis that such pre-contractual expenditure could not amount to an 'investment' for the purposes of the ICSID Convention or the USA- Trinidad & Tobago Bilateral Investment Treaty. A different position had been reached by a tribunal in the Mihaly v. Sri Lanka (ICSID Case No. ARB/00/2, 15/03/02). The tribunal did not seek to explain in detail why the present case was justifiably different from Mihaly (FWO at para 126). The tribunal made it clear that a state changing its position on the offer of a successful tender with reason did not amount to a lack of good faith (FWO at para 179). It did not, however, sadly give any qualification as to what justifiable 'reasons' might be, and implicitly left a broad right to states to withdraw with no compensation for the investor. It is not clear on the facts how in this case such a decision by the partially state controlled bodies was not arbitrary. Not having put the Mihaly distinction to bed, the case still leaves open the question: Under what circumstances is pre-contractual expenditure a justifiable 'investment' for the purposes of the ICSID Convention and a similarly worded investment treaty to the US-Trinidad & Tobago BIT?

The answer to this question depends on one's views of the purpose of ICSID and investment

treaties. Staying true to their aims of providing capital for sustainable economic development (the aims of the World Bank's ICSID project), judicial constructions of 'investment' have to mirror this. Thus unnecessary loss of capital through pre-contractual expenditure should generally be wastage as far as Contracting Parties are concerned. Taking the facts as the FWO tribunal has narrated them, there was no clear basis why the state controlled entities withdrew the tender after it had been acquired by the claimant causing it loss. The oil fields that the investor sought to exploit were left unused up to the date of the decision. As far as the overarching policy of ICSID is concerned this is waste. Where the tribunal got lost is drawing parallels between how rights are created as a matter of domestic law, with the mutually exclusive conceptualization of public international treaty obligations. To put it simply, it does not follow that a lack of a cause of action for pre-contractual expenditure in domestic law leads to no rights of action on the same facts in treaty law. It is simply irrelevant whether one or more jurisdictions do or do not recognize pre-contractual liability to liability in public international law. One way to look at it might be to say that the aims of the treaties consumes all such distinctions.

To protect capital expenditure and the aims of investment treaties and ICSID an approach closer to the overall goals of the system is need of judicial elucidation. One approach may be to couple protection in this issue with the existing doctrine of legitimate expectations. Thus the definition of investment may include: 'Where an investor as made legitimate expenditure in the pursuit of real expectation of contract'. This would remove mere expenditure where the award of contract is speculative from protection. The tribunal rightly intimated this as the commercial risk of contractual relations (FWO at para 141). However risk cannot be so broad as to include all expenditure in all circumstances of pre-contractual relations. Otherwise it would undermine the purpose of the investment treaty to encourage cross-border commercial venture. There will be a point were state behaviour reduces commercial risk by increasing likelihood of the contract being awarded. It needs to then be determined whether excess expenditure in this regard, beyond a mere speculative input of capital, justifies protection as an 'investment'. There are many cases less clear than direct inducement as in Mihaly, where this will be so. The remarkable aspect of FWO is that the tender for contract had been awarded, and only the formality of formation was left. Adequate focus on the expenditure in this period or the likelihood of being awarded the tender (which must in my view give rise to a treaty right) was not carried out by the tribunal. The latter is no doubt still speculative. There may be a case for different approaches to the pre-contractual expenditure issue between cases of tendering process and the investor as a sole negotiator for the contract. The latter may justify a greater degree of protection where the state's conduct is tantamount to inducement. However judicial tests need to be carefully construed to meet these exigencies, to ensure appropriate investor protection. My example based on expectations is merely suggestive, however it is clear that a better balance than in FWO needs to be struck between risk and protection. At the moment the approach in Mihaly is far closer to overall aims of the investment treaty system.

Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.

This entry was posted on Tuesday, March 2nd, 2010 at 4:31 pm and is filed under International Legal Theory and Teaching, Investment Arbitration, Other Issues
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.