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Can an Investor Claim Lost Profits for Breach of Pre-contractual Relations?

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An abundant number of agreements have been and will be concluded between states and investors operating under the bilateral investment regime and even a larger number of negotiations will fail before reaching the final stage of signature. An investor may spend large sums of money with the aim of concluding an agreement with the state. If the final agreement is not signed, these investments may be lost. Is the bilateral investment regime able to assist investors where investors spend large sums of money and where the negotiations are terminated by the state? Would the investor only be able to recover its costs or could the state also be liable for the investor's lost profits?

The recent award of the arbitral tribunal composed of Daniel Price, Professor Brigitte Stern and presiding arbitrator Hon. Marc Lalonde in the investment arbitration case *Luigiterzo Bosca v the Republic of Lithuania* revisited the issue of protection of pre-contractual rights under the investment treaties. The award explored the issues of pre-contractual rights and the definition of investment under the BITs. It also addressed the extent of a state's liability in cases of breaches of pre-contractual relations between an investor and a state.

Awards preceding the arbitral tribunal's decision in *Luigiterzo Bosca v the Republic of Lithuania* have predominantly rejected the investors' claims arising out of pre-contractual relations. The arbitral tribunals invariably concluded that pre-contractual expenditures or pre-contractual rights were not an investment under the applicable BIT (see, e.g., Mihaly v Sri Lanka, Zhinvali v Georgia, William Nagel v Czech Republic, F-W Oil Interests v Trinidad & Tobago). Therefore, the claims were dismissed because of a lack of the tribunals' jurisdiction over the dispute not arising out of an investment.

The stage of pre-contractual relations between the investor and the state, however, did not bar the arbitral tribunal from exercising the jurisdiction in *Luigiterzo Bosca v the Republic of Lithuania*. Even though the arbitral tribunal went one step further, as opposed to earlier decisions rejecting the claims on the grounds of lack of investment in the host state, the *Bosca* award shows that in similar circumstances the investor may not expect more than the recovery of wasted costs.

"Bosca" branded production of sparkling wines is probably the second most known brand of sparkling wines in Lithuania after the national brand "Alita". The state-owned producer of sparkling wines "Alita" was privatized in 2003 and the Italian national Luigiterzo Bosca was among 4 bidders who participated in the public tender for acquisition of Alita. Mr Bosca's bid was the highest and he was declared the winner of the public tender. Mr Bosca and the privatization agency of Lithuania entered into negotiations over the share purchase agreement.

The negotiations went smoothly and only several issues were left to be agreed upon between the parties. However, the privatization agency held to its guns and was not willing to reduce the requested size of contractual fines. The privatization agency declared "take it or leave it" and set the deadline for agreement on the final version of the text. After Mr Bosca had failed to initial the text of the agreement within the set time frame, it withdrew from the negotiations with the Italian sparkling wine producer.

Luigiterzo Bosca then sued the privatization agency for its failure to observe the tender regulations, the Lithuanian Civil Code provisions prescribing the duty to act in good faith in pre-contractual relations and requested the state to compensate his out-of-pocket expenses incurred in the process of negotiations with the state. The case went through all the three instances and the Supreme Court of Lithuania recognized that Mr Bosca was mistreated in the tender process and awarded him the direct damages. The judgment of the court was executed and Mr Bosca was compensated his direct damages.

The Italian national felt that the justice was still not done – a few years later Mr. Bosca initiated the *ad hoc* arbitration proceedings under the UNICTRAL rules of arbitration and submitted a claim against the state under Italy-Lithuania BIT. Mr Bosca alleged the state's failure to accord just and fair treatment, national treatment, most-favoured nation treatment and guarantees of legal expropriation. The investor claimed that "but for" the state's conduct Mr Bosca would have earned around EUR 207 million from operating Alita.

The state requested to dismiss the Mr Bosca's claim on various grounds, including the absence of investment in the state, failure to prove the breaches of the state's international obligations and the fact that the Italian national was already compensated by the local courts.

The arbitral tribunal concluded that it had jurisdiction over the dispute because Mr Bosca's involvement in the alcohol market of Lithuania by way of providing services to the company producing "Bosca" production constituted "know-how" under Article 1(1)(d) of the Italy-Lithuania BIT. Accordingly, the service agreement had the necessary elements of contribution, risk and duration typically considered the basic characteristics of an investment. Something not often seen in investment arbitration – the arbitral tribunal recognized that Mr. Bosca's participation in Alita tender was an "associated activity" in the form of "making of contract" under the Protocol of the BIT.

The Protocol to the Italy-Lithuania BIT extends the treaty protection to various activities associated to investment, e.g. "the dissemination of commercial information", "the acquisition of property" and, as referred to by the tribunal, "the making of contract". The extension of treaty protection not only to investment, but also to activities associated to investment, is an unusual, but not unseen, construction of bilateral investment treaties. Arguably, the Italy-Lithuania BIT was influenced by the same generation of USA BITs which also grant treaty protection to "associated activities" similar to the ones listed in the Protocol of the Italy-Lithuania BIT (see, e.g., Article I.1(e) of the USA-Lithuania BIT or Article I.1(e) of the USA-Latvia BIT).

Having concluded that Mr. Bosca's participation in Alita tender constituted the "making of contract" under the Protocol of the BIT, the arbitral tribunal noted that the issue was not about the state's interference with Mr. Bosca's investment – the service agreement. The service agreement which was concluded by the Italian investor with the producer of "Bosca" production in Lithuania could not have been affected by the state's decisions to withdraw from the negotiations with Mr. Bosca. However, Mr. Bosca's participation in the tender was "associated activity" to Mr. Bosca's prior investment in Lithuania. Particularly the "associated activity" in the form of "making of contract" was the object of the alleged interference by the state.

On the merits, the arbitral tribunal found the state liable for its failure to accord a just and fair treatment to Mr. Bosca's "making of contract" in Lithuania. The arbitral tribunal decided not to examine any further alleged breaches of the treaty by noting that in any event any other breaches would not lead to awarding any additional damages to Mr. Bosca.

On the quantum phase of the case, the arbitral tribunal completely rejected Mr. Bosca's claim for EUR 207 million in damages. The grounds for dismissing the claim on damages were primarily facts-specific, e.g., the tribunal stated that it was not clear if the parties would have eventually agreed on all issues before concluding the contract. However, the tribunal's reasoning shows its inclination to accept the principal position that in pre-contractual relations the putative investor should not expect more than recovery of out-of-pocket expenses. The arbitral tribunal stressed that the parties were still in pre-contractual relations and, relying on arbitral and doctrinal support, concluded that damages based on assumption of the concluded contract were too remote and speculative. As a result, Mr. Bosca was only entitled to the recovery of direct damages. Since the direct damages were already compensated to Mr. Bosca, the claimant's entire request for damages was entirely dismissed.

Luigiterzo Bosca v the Republic of Lithuania may be one of rare awards where an investor's treaty claim arising out of pre-contractual relations managed to overcome the jurisdictional hurdle of "investment". This was determined by the following two factors: *first*, the investor's prior involvement in the state which was an "investment" and a platform for further expansion by way of negotiations over the transaction; and, *second*, favourable treaty provisions not only granting protection to investment, but also extending the scope of protection to "associated activities", such as "making of contract".

However, *Luigiterzo Bosca v the Republic of Lithuania* award suggests that the arbitral tribunals may be reluctant to award more than direct damages either in all cases where the parties are still in pre-contractual relations or the threshold may be very high, i.e. the conclusion of a contract must be a certainty in order to award the lost profits to the investor.

The authors of this article acted as counsels to the state in the arbitral proceedings Luigiterzo Bosca v Lithuania. The purpose of this article is not to assess, but to provide a brief overview of the findings and the reasoning of the arbitral tribunal's award. Hence, any statements provided in this article are without prejudice to the position of the counsel or the state itself in the arbitral proceedings against Luigiterzo Bosca. In this article Luigiterzo Bosca is also mentioned as "the investor", however the state disputed the claimed investments of Mr. Bosca in terms of Lithuania-Italy BIT. Hence, this cannot be used as an admission of Mr. Bosca's status as an investor possessing "investment" under Lithuania-Italy BIT.

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