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Pre-?nvestment Expenditures, Defining an Investment, and a Problem of Translations: Patel Engineering v the Republic of Mozambique

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The *Patel Engineering Limited ("PEL") v the Republic of Mozambique* tribunal, constituted under the UNCITRAL Arbitration Rules, dealt with pre-investment expenditures and whether such expenditures constitute a protected investment.

Investors frequently make expenditures in the preparatory phase of an investment, such as environmental impact assessments, scientific surveys, or financial advice. When are these expenditures considered an investment?

While the language of the bilateral investment treaty ("BIT") provided a clear definition of investment, this dispute was complicated by differing versions of the underlying contract. This post will first give a short background of the relevant facts, discuss the legal basis for the dispute and tribunal's analysis, turn to an overview of pre-investment expenditures, and finally provide a short critique of the award.

Background to the Dispute

PEL, an Indian company, planned to build and operate a railway network and port infrastructure connecting the resource-rich region of Moatize in the Tete province to a location in the Mozambique Channel near Macuse (Award, para 162). The railway corridor would transport minerals, including coal, for export (Notice of Arbitration, para 2).

PEL signed a Memorandum of Interest ("MOI") on May 6, 2011 with the Ministry of Planning and Development and the Ministry of Transport and Communication (Award, para 163). The parties agreed to a feasibility study, with the costs borne by PEL. The MOI contained a clause providing for arbitration under the International Chamber of Commerce ("ICC") Rules.

MOI negotiations were conducted in English with the Portuguese version only developed to satisfy requirements under Mozambican law, according to the claimants (Notice of Arbitration, para 33). Three versions of the MOI were presented during the dispute (Award, para 368). The difference in versions could not be adequately explained by the parties (Award, para 174). The respondent was not able to locate the original English translation of this MOI as signed by the parties (Award,

paras 60, 176).

The Portuguese version (and direct English translation) provided for a "*direito de preferência*" — equivalent to a right of first refusal: "PEL shall carry out a pre-feasibility study (PFS) within 12 months and will submit to the government for the respective approval."

An English translation, upon which PEL relied, also provided that the company would have the "right of first refusal" should the exploratory phase be successful, and further indicated that the government of Mozambique "shall issue a concession of the project in favour of PEL." The tribunal accepted the claimant's interpretation of the MOI *pro tempore*. However, they interpreted this agreement to mean that "PEL was entitled to an '*ajuste directo*' of the concession" based on the newly-enacted Public-Private Partnership ("PPP") Regulation (Award, para 370); the party would be invited to directly submit a proposal, requiring certain elements, including the creation of a PPP (Award, paras 378-380).

Following the feasibility study, PEL requested the formation of the PPP with the Mozambican Directorate of Ports and Railways ("CFM"). CFM was not able to contribute the 20% needed for the project. The government opened a public tender process. Shortly after the public tender was opened, the Council of Ministers "decided to invite" PEL to start the process of carrying out the project (Award, para 202); the offer was rescinded less than a month later (Award, para 205). The concession was ultimately granted to another company.

The Investment Dispute

PEL initiated the arbitration under the India-Mozambique BIT based on a breach of pre-concession rights. Two months after the request for arbitration, the respondent initiated ICC arbitration. The investment tribunal denied the respondent's request to stay the proceedings after the issuance of an ICC injunction — an exceptional situation in a treaty arbitration. The parties refused to consolidate. The bifurcation request was also denied based on the "inextricably intertwined" issue of whether there was an investment (Award, para 233).

The Tribunal's Analysis of the Investment

The case rested on whether the pre-investment expenditures made by the company in anticipation of receiving the concession agreement could be protected as an "investment".

> "There is no dispute regarding the fact that Mozambique never awarded PEL a concession to develop the Project. What the Parties discuss is whether Claimant's rights enshrined in the MOI, together with its expenditures and activities (prior to Mozambique's decision to award a concession to ITD/TML, and not to Claimant) are covered investments under the BIT" (Award, para 269).

Defining Investments

Article 1(b) of the BIT provided that an investment is "every kind of asset established or acquired, including changes in the form of such investment in accordance with the national laws of the Contracting Party in whose territory the investment is made". The BIT specified that this includes "business concessions conferred by law or under contract", "rights to money or to any performance under contract having a financial value", and "intellectual property rights".

The tribunal concentrated its analysis on the BIT, and noted that regardless of the forum, the scope of "investment" would be unchanged (Award, para 284). The arbitrators considered an "inherent meaning of investment" (Award, para 280), and identified the common features of an investment as:

1. A contribution of capital or equivalent value made by the investor;
2. The ownership of, or entitlement to, an asset with value, located in the host State, that results from such contribution;
3. An asset which is expected to produce a return, in the form of "profit, interest, capital gains, dividends, royalties and fees"; and
4. A certain duration (Award, para 318).

The tribunal considered a normal commercial contract to be beyond the scope of the BIT, namely that "investments […] involve a capital outlay for the establishment or acquisition of an asset, which is expected to generate returns in due course" (Award, para 319). "Long-term construction contracts or concession contracts" would be considered as meeting the requirements (Award, para 320).

Pre-investment Activities

The tribunal questioned whether the pre-feasibility study and the MOI, as pre-investment activities, fit into the definition of investment. Relying on Professor Schreuer's work on the subject, the tribunal indicated that "pre-investment activities, even if formalized under certain contracts, are generally not protected as investments under international investment agreements" (Award, para 325). Returning to its established definition of investment, the tribunal considered that pre-investment activities failed to meet the requirements: "they do not entail a contribution, which results in the establishment or acquisition of an asset, which in turn is expected to produce a return for the benefit of the investor over an extended period of time" (Award, para 326).

Regarding the pre-feasibility study, the tribunal found that the amount claimed was unsupported by evidence, and that the expenses were to be borne by the claimant according to the MOI (Award, para 363). They further declined to consider the findings to be classified as intellectual property rights (Award, para 364). With respect to the MOI, even if relying on the claimant's version, the tribunal found that there was neither a contribution nor certainty that the concession would be awarded (Award, para 380).

The majority, Professor Juan Fernández-Armesto and Mr Hugo Perezcano Díaz, declined jurisdiction *ratione materiae*. In particular, they considered the dispute contractual in nature (Award, paras 328, 369). The dissenting arbitrator, Professor Guido Santiago Tawil, disagreed with the majority, considering the special status granted to the claimant to be of economic value, and its

relationship with the state to be more substantial than a "simple participant in the [p]ublic [t]ender" (Dissenting Opinion, para 12).

Theoretical Approach to Pre-Investment Expenditures

Tribunals typically apply a high threshold for pre-investment expenditures under the definition of investment (McLachlan, Shore, and Weiniger, 2017, p. 237). Expenditures prior to the investment do not create economic value. Article 25 of the ICSID Convention intentionally leaves flexibility for international investment agreements to define "investment" and the possibility of pre-investment protections. The ICSID Commentary notes that "the main focus […] has been to determine when pre-investment activities end and when a protected investment starts" (Article 25, para 387). Therefore, the language of the BIT largely determines whether pre-investment expenditures are investments.

Several agreements explicitly provide for pre-investment protection. Article 10(2) of the Energy Charter Treaty provides that "[e]ach Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3)". The PEL tribunal referenced the US-Mexico-Canada Agreement, providing a similar temporal breadth (Award, para 334; USMCA, Chapter 14).

In disputes where tribunals have declined jurisdiction over pre-investment expenditures, there are usually no contractual relationships formed by the state and the investor despite the expenditures (see *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, Award, paras 60-61 [US-Sri Lanka BIT]; *Zhinvali v Georgia* [applying Georgian investment law]).

By contrast, binding commitments in the form of a concession, even when not advanced, have been sufficient to include pre-investment expenditures. A concession contract had been signed in the *PSEG v Turkey* dispute, although the investment never advanced; jurisdiction was maintained. In *Bear Creek Mining v Peru*, the claimant had authorization to attain mining rights, later revoked after protests against the mining project, and the majority found that there was an investment (Award, paras 283-85). These decisions build on the unity of investment theory, meaning that the expenditures are included in the scope of investment once that investment has been deemed to exist.

In general, the contract must have been of such a nature to transform the commitment into something of more long-term value with the potential for return.

Discussion

PEL v Mozambique largely follows the established case law regarding pre-investment expenditures. Essentially, the tribunal focused on the BIT language. The fact that the MOI provided for expenses to be borne by the claimant limited any potential for it to be elevated to the status of an investment. Moreover, a local company was never formed and the contribution was never established.

Nonetheless, aspects of pre-investment expenditures and process were disregarded in the reasoning

despite the “intertwined” nature between jurisdiction and merits. The decision turned substantially on the MOI. The claimant’s version, without the procedural requirement of the new PPP Regulation, seemingly offered a more direct right to the concession. The conclusion of the PPP was obstructed by CFM, a government entity, party in the ICC proceeding, and partner in the winning public tender. Thus, although a contractual dispute, the ultimate decision in that matter left potential for additional rights.

The coverage of an investment should not be stretched in all temporal directions. The consideration of the BIT language for determining the existence of an investment was a valuable approach, but the intertwined issues and government assurances could have been further explored to clarify this issue of pre-investment protection.

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