ACCESSING FOREIGN INVESTMENT PROTECTION FOR INTERNATIONAL CONSTRUCTION AND ENGINEERING PROJECTS

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Recent years have seen an increase in the amount of cross-border activity in the construction and engineering sector, particularly for projects in developing economies. In 2012, PwC noted that "infrastructure spending has begun to rebound from the global financial crisis and is expected to grow significantly over the coming decade" and predicted that "some regions, particularly emerging Asia, are projected to enjoy a bigger boom in infrastructure development than more advanced economies."[2] This prediction was soon reflected in the market. Almost half of the major construction and engineering firms surveyed by KPMG in 2013 indicated that they planned to expand internationally by targeting projects in new locations, most commonly in Africa and Asia, and particularly major infrastructure projects in the energy, mining, rail and water sectors.[3] This increased international activity was observed by the United Nations Conference on Trade and Development ("UNCTAD") in 2015; it estimated that the amount of foreign direct investment ("FDI") for the construction of greenfield projects in developing economies had jumped from US$22 billion in 2013 to US$42 billion in 2014, with year-on-year increases experienced particularly in the least-developed economies (562% increase from 2013 to 2014), East and South-East Asia (116%), West Asia (136%) and developed economies (55%).[4] This trend is expected to continue in the medium term, with investment in international construction projects forecast to rise, particularly for large infrastructure projects in developing countries.[5]

Many of the locations for these new projects have traditionally been perceived as having higher country risk factors, including greater political

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[2] PwC, *Capital Project and Infrastructure Spending: Outlook to 2025*, 2015, p 23.

[3] KPMG, *Global Construction Survey 2013: Ready For The Next Big Wave?*, October 2013, p 14.

[4] UNCTAD, *World Investment Report 2015: Reforming International Investment Governance*, 2015, pp 14, 40, 53 and 72.

[5] See, e.g., UNCTAD, *ASEAN Investment Report 2015 – Infrastructure Investment and Connectivity*; 2015; PwC, *Capital Project and Infrastructure Spending: Outlook to 2025*, 2015; FDI Intelligence, *The fDi Report 2014 – Global Greenfield Investment Trends*, Financial Times Ltd, 2014; Turner & Townsend, *International Construction Market Survey 2015 – Global Rebalancing: A Changing Landscape*, 2015.

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uncertainty, less-predictable government policy or higher levels of exposure for foreign investors. Such concerns are, however, not new. For decades, developing States have been aware of these concerns and have sought to attract foreign investment (both in the construction sector and more broadly) by committing to protect incoming investors and their investments against the possibility of expropriatory, unfair or discriminatory treatment by public authorities within their territories. Capital exporting States have sought to ensure an equal but opposite concern, namely to reduce risks faced by their capital exporting entities. For this reason, capital importing and exporting States wishing to protect or attract investment have agreed on protections to be offered to investors by the host State into which the investment is made. These protections take the form of international legal obligations contained bilateral investment treaties ("BITs") between two States in which each State grants rights and protections to investors from the other State investing into it, or in the investment chapters of free trade agreements ("FTAs"), or in multilateral investment treaties ("MITs") which apply similarly as between multiple States.

By carefully planning their corporate structures and investments at an early stage, developers, contractors and other investors involved in cross-border projects often seek to benefit from these international commitments, and may secure important protections from possible harmful interferences by the host State. These protections are given effect through an aggrieved investor exercising its right to bring arbitral proceedings against a host State for that State's breaches of its protection commitments offered to investors. Foreign investments in the construction sector have given rise to a significant proportion of the known investment treaty disputes. Claims have been brought under BITs in relation to the construction of major infrastructure works including highways,[6] canals,[7] hydro-electric projects[8] and pipelines[9] as well as smaller or individual projects and developments.[10]

These claims are not only brought by investors from developed States. Investors from countries which were previously seen as capital-importing are now also bringing claims under BITs, particularly in the construction sector. Turkey is a pertinent example: while Turkey has signed over 100 treaties to attract inward investment, over the past decade Turkish construction firms have expanded outwards and are the second largest nationality, after China,

[6] *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29, Award, 27 August 2009; *Consortium RFCC v Kingdom of Morocco*, ICSID Case No ARB/00/6, Award, 22 December 2003.

[7] *Jan de Nul NV and Dredging International NV v Arab Republic of Egypt*, ICSID Case No ARB/04/13, Award, 6 November 2008.

[8] *Impregilo SpA v Islamic Republic of Pakistan*, ICSID Case No ARB/03/3, Decision on Jurisdiction, 22 April 2005.

[9] *Saipem SpA v People's Republic of Bangladesh*, ICSID Case No ARB/05/7, Award, 30 June 2009.

[10] *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Award, 8 December 2000.

of major construction firms working globally.[11] As of 2016 there have been at least 19 known investment arbitration claims brought by Turkish investors making investments into other host States,[12] of which at least nine involve large Turkish construction contractors with multi-million dollar projects in other countries.

In fact, a significant proportion of recent investment arbitrations from all regions involve international construction and engineering projects; from 2011 onwards, construction disputes have formed between 5 to 8% of new investment disputes registered each year with the World Bank's International Centre for the Settlement of Investment Disputes ("ICSID").[13]

Despite the increasing proliferation of investment treaty claims, investors do not automatically qualify under BITs, MITs or FTAs to bring such claims. This article examines the legal criteria surrounding a foreign investor's qualification for protection offered by a host State, focusing on the construction sector. Specifically, the article provides a brief general discussion of the types of protections offered by host States to incoming foreign investors. It then explores the gateway jurisdictional and qualifying criteria which should be met for international cross-border investors and their projects to access the benefits from the protections offered by host States. It focuses on the gateway issues specific to the construction sector which may arise when assessing whether developers, contractors, employers would be able to benefit from such protections for any particular projects. Finally, the article presents preliminary suggestions for foreign investors

[11] Engineering News-Record, ENR Top 250 International Contractors, 2016, http://www.enr.com/toplists/2015_Top_250_International_Contractors1. See also *Daily Sabah*, "Turkish contractors rank second in the world for 8th year in a row", 23 August 2015, http://www.dailysabah.com/money/2015/08/24/turkish-contractors-rank-second-in-the-world-for-8th-year-in-a-row.

[12] See *Aktau Petrol Ticaret AŞ v Republic of Kazakhstan*, ICSID Case No ARB/15/8, pending; *Federal Elektrik Yatırım ve Ticaret AŞ and Others v Republic of Uzbekistan*, ICSID Case No ARB/13/9, pending; *Güneş Tekstil Konfeksiyon Sanayi ve Ticaret Ltd Şirketi and Others v Republic of Uzbekistan*, ICSID Case No ARB/13/19, pending; *Karkey Karadeniz Elektrik Uretim AS v Islamic Republic of Pakistan*, ICSID Case No ARB/13/1, pending; *Erbil Serter v French Republic*, ICSID Case No ARB/13/22, pending; *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v Turkmenistan*, ICSID Case No ARB/12/6, pending; *İçkale İnşaat Ltd Şirketi v Turkmenistan*, ICSID Case No ARB/10/24, Award, 8 March 2016; *Erhas Dis Ticaret et al v Turkmenistan*, UNCITRAL, Award, 8 June 2015, confidential; *Turkcell İletişim Hizmetleri AŞ v Islamic Republic of Iran*, UNCITRAL, Award, 15 October 2014, confidential; *Türkiye Petrolleri Anonim Ortaklığı v Republic of Kazakhstan*, ICSID Case No ARB/11/2, Award (settlement), 18 August 2014; *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v Turkmenistan*, ICSID Case No ARB/10/1, Award, 2 July 2013; *Ömer Dede and Serdar Elhüseyni v Romania*, ICSID Case No ARB/10/22, Award, 5 September 2013; *Karmer Marble Tourism Construction Industry and Commerce Ltd Liability Company v Georgia*, ICSID Case No ARB/08/19, Award, 9 August 2012; *ATA Construction, Industrial and Trading Company v Hashemite Kingdom of Jordan*, ICSID Case No ARB/08/2, Award, 18 May 2010; *Barmek Holding AS v Republic of Azerbaijan*, ICSID Case No ARB/06/16, Award (settlement), 28 September 2009; *Sistem Mühendislik Inşaat Sanayi ve Ticaret AŞ v Kyrgyz Republic*, ICSID Case No ARB(AF)/06/1, Award, 9 September 2009; *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29, Award, 27 August 2009; *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v Republic of Kazakhstan*, ICSID Case No ARB/05/16, Award, 29 July 2008; *Bozbey Insaat Sanayi ve Ticaret and Omer Faruk Bozbey v Turkmenistan*, UNCITRAL, discontinued.

[13] ICSID, Annual Report 2015, p 25; ICSID, Annual Report 2014, p 24; and ICSID, Annual Report 2012, p 29.

to consider when assessing whether to structure (or to restructure) international construction projects in order to meet the necessary gateway jurisdictional criteria and thereby qualify for protections offered by host States to incoming investments.

INTERNATIONAL INVESTMENT AGREEMENTS

The key protective feature of investment treaties is the right offered directly to investors to bring a claim against the host State before an international arbitral tribunal for violations of the State's protective obligations. Notably, the host State's obligation to protect, and the offer to arbitrate in the event of breach, is not contingent on an investor concluding a contract with the government itself – the right to benefit from treaty protection applies to all investors from the home State which invest in the host, provided that they and/or their investments would qualify under the relevant BIT for such protection.

There are over 2,700 BITs in operation worldwide, and almost all countries are party to at least a few BITs.[14] Many tax effective jurisdictions such as the Netherlands, Belgium or Luxembourg, and common investor hubs such as the USA, the UK and Germany, have a broad range of BITs with other States. The international matrix of BITs also includes a high number of so-called south-south treaties,[15] estimated to be around 40% of the total,[16] where developing countries which were not traditionally capital-exporting have entered into BIT with each other to promote foreign direct investment ("FDI") between themselves. This corresponds to a larger trend of enhanced south–south economic cooperation. Since 2008–2009, developing countries have exported more to each other than to developed countries.[17]

[14] Not all States agree, however, that economic data would support the view that investment treaties do indeed promote inward investment. For example: Brazil, a relatively large economy, has no investment treaties currently in effect (it has recently signed BITs with certain trading partners but these are not yet in effect) (see, e.g., Leany Barreiro Lemos and Daniela Campello, *The Non-Ratification of Bilateral Investment Treaties in Brazil: A Story of Conflict in a Land of Cooperation*, 1 April 2013, SSRN Electronic Journal). South African government policy is to terminate its BIT matrix following a review that concluded that there was, at best, an ambiguous relationship between inward foreign direct investment and South Africa's BITs and that a significant proportion of South Africa's foreign investment came from jurisdictions without BITs (see, e.g., Republic of South Africa, *Bilateral Investment Treaty Policy Framework Review*, Government Position Paper, June 2009).

[15] South-south investment treaties are those signed as between developing countries. See, e.g., Mahnaz Malik, "South-South Bilateral Investment Treaties: The same old story?", International Institute for Sustainable Development, 2011.

[16] Lauge Skovgaard Poulsen, "The Significance of South-South BITs for the International Investment Regime: A Quantitative Analysis", 30 *Nw. J. Int'l L. & Bus.* 101, 2010, p 101.

[17] UNCTAD, South-South Trade Monitor No 2, July 2013, p 1. See also Report of the UN Secretary General, State of the South-South Cooperation, A/69/153, 17 July 2014, p 2.

The increase in the numbers of BITs consequently results in an increase of the numbers of potential foreign investors with rights to access the remedies contained within the BITs, particularly the right for an investor to bring arbitral proceedings against a signatory State. Moreover, as foreign investors increasingly appreciate the risk-reducing potentials that treaty protections provide to them, the numbers of foreign investments which are in fact structured precisely to obtain treaty benefits is generally seen to be rising. These trends may explain the year-on-year increase to investment arbitrations and FDI disputes globally.[18] Although the number of arbitrations is growing, however, investors are not necessarily automatically entitled to claim the benefits of available BIT protections. An investor's right and ability to bring an arbitration against a host State arises from three fundamental pillars found in almost all BITs/MITs/FTAs:

- First, the protections offered by States to foreign investors which create actionable obligations for a host State towards investors and investments from the other State. A breach by a host State of its BIT obligations may give rise to liability towards an investor, and thereby a potential cause of action for an investor which may be determinable by arbitration.
- Second, the qualifying gateway criteria as defined in the BIT. Whether the investor itself qualifies as a defined "investor" of the home State and, therefore, benefits from the host State's obligation to protect investors of the home State; and also whether the investor's foreign project investment into the host State similarly qualifies as a protected "investment".
- Third, the host State's offer of arbitration to resolve a dispute arising from an alleged breach of its protective obligations. The host State's offer to arbitrate is an unilateral open offer made in the BIT to any qualifying "investor" from the other State which has made a qualifying "investment". Investors value the opportunities for redress which are made available through international investment arbitration, particularly where concerns may exist as to the neutrality or fairness of a host State's local court procedures.

This arrangement has been described as the "quid pro quo" between a foreign investor and a host State:

> "in exchange for contributing to the flow of capital into the economy of the host contracting state, the nationals of the other contracting state are given the right to bring international arbitration proceedings against the host contracting state and to invoke the international minimum standards of treatment contained in the respective investment treaties".[19]

[18] UNCTAD, "Number of international investment disputes mushroomed in 2012, UNCTAD reports", UNCTAD/PRESS/PR/2013/007, 10 April 2013.

[19] Zachary Douglas, *The International Law of Investment Claims*, 2009, Cambridge University Press, p 161.

The following sections examine the parameters and requirements of the first and second pillars, and which are given effect by the investor's right under the third pillar to bring arbitral proceedings.

PROTECTIONS OFFERED TO INVESTORS BY A HOST STATE

This section briefly discusses the protections offered to investors by a host State, and presents some recent examples of claims by foreign investors in the construction and engineering sectors for alleged breaches of investment treaty protections offered by host States.

Some of the most common protections offered by host States to investors (including developers, employers, contractors and others investing capital internationally) and to their projects or other investments under BITs are: not to expropriate or nationalise investments except for a public purpose, on a non-discriminatory basis and on payment of prompt, adequate and effective compensation; to accord fair and equitable treatment to the investments of investors of the other State; not to take unreasonable or discriminatory measures against those investors; not to treat those investors and/or their investments less favourably than the host State's own investors and their investments (known as "national treatment"), or those of any third country (known as "most favoured nation" status); and to provide full protection and security, or protection by the State from interference by third parties, and the provision of a secure environment for the investor's investment.

Certain actions taken by the host State, its organs or agencies such as regulators, police, ministries, local authorities, licensing authorities etc., involving the exercise of State power which cannot be exercised by a mere contractual counter-party, may give rise to breaches of its protective commitments, which in turn may negatively affect the value of an investor's project.

Traditionally, claims arising from expropriations were the primary claims brought by foreign investors against States, and investors seeking comfort for their foreign investments thus sought protection from expropriation or from other State interferences with their property rights. States are however unwilling to give up their rights of action over property located in their jurisdiction (expropriation being the most extreme expression of a State exercising this right), so rather than commit not to carry out expropriations in future, States have instead used BITs to define the conditions for expropriations, therefore offering protection to investors that their investments would not be unlawfully expropriated. Claims for direct expropriations have become less common recently, while claims for indirect expropriations, leaving the investor's ownership title untouched but removing all value within the asset, appear to have gained in number.

It is, however, difficult to define precisely which situations are covered by the concept of an indirect expropriation, and recent decisions have preferred to find a violation of the standard of "fair and equitable treatment" instead of an indirect expropriation.[20]

"Fair and equitable treatment" is generally the most frequently invoked protection, and has significant practical relevance.[21] It is concerned with fairness of treatment of investors by the host State in relation to administrative decision making and the State's judicial system.[22] It is valued by foreign investors because of its potential application to a wide range of circumstances, and it has been interpreted broadly by tribunals to encompass the effects of many different actions by States. In this respect, the fair and equitable treatment standard has been said to fill gaps which may be left by other more specific standards as it "may offer redress where the facts do not support a claim for expropriation"[23] in order to obtain the level of investor protection intended by bilateral investment treaties.

"Full protection and security" encompasses protection of foreign investors in different types of situations ranging from acts committed by insurgents or rioting groups in the host State to acts undertaken by the governmental police authorities or military units, and even to governmental regulatory acts which disturb the legal stability on which the investor relied when the investment decisions were made.[24] The "protection against unreasonable and discriminatory measures" assures foreign investors that host States will respect the rule of law, prevent arbitrary action and not discriminate on the basis of the investor's foreign nationality. The contingent standard of "national treatment" assures foreign investors to be treated at least as favourably as nationals of the host State. Similarly, "most-favoured nation" treatment requires a standard of treatment to the investor which is no less favourable than that offered to foreign investors from other third States.

As noted above, there have been many investment treaty claims in the construction sector. These have arisen as a result of many different types of actions by host States, giving rise to arbitral awards to the value of tens or even hundreds of millions of dollars. For example, the value of a contractor's interests in a consortium responsible for the construction, maintenance and operation of a toll road and several bridges in northern

[20] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, p 101.

[21] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, p 130.

[22] Campbell McLachlan QC, Laurence Shore, Matthew Weiniger, *International Investment Arbitration: Substantive Principles*, Oxford University Press, 2007, paragraph 7.76.

[23] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, p 130.

[24] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, p 161.

Argentina fell dramatically following Argentina's pesification policy[25] during the 2001–2002 financial crisis. An investment tribunal held that Argentina's failure to restore and redress the commercial balance in the concession contract amounted to a breach of the standard of fair and equitable treatment contained in the Argentina–Germany BIT.[26] In another instance, a tribunal decided that the fair and equitable treatment standard of the Austria-Ukraine BIT was breached when Ukraine turned a hotel complex owned by a foreign investor into a public corporation owned solely by Ukraine, thus violating the investor's legitimate expectations that the Ukrainian government would not interfere in the contractual relationship between the investor and the hotel.[27] Lastly, a tribunal found that the fair and equitable treatment provision in the Netherlands–Turkey BIT was not violated by the Turkish government because the foreign contractor's legitimate expectations were not breached when Turkey failed to grant extensions and terminated contracts for a real estate development project in Istanbul.[28]

The unifying characteristic of State actions which give rise to breaches of investment treaty obligations is the exercise by the State, the government, its authorities and officials (whether national or local) of powers which an ordinary contracting party could not exercise; hence, arbitrary or unfair exercise of licensing powers, granting of concessions, changes to currency rules, arbitrary or discriminatory taxation, extra-contractual treatment, unfair zoning and planning regulations, or onerous environmental obligations are typical actions which give rise to investment treaty claims. It is for this reason that the primary beneficiaries of investment protections in the construction sector are generally main contractors, developers, employers or other entities whose position in the chain of procurement would expose them to the risk of arbitrary actions by the host State. Generally, entities lower down the project chain would not be directly affected by arbitrary actions by a host State breaching its international obligations, any actions that a sub-contractor or other similar entity may bring would generally be against its contractual counterparties higher up the chain of procurement and sub-contractors are usually (but not always) unlikely to have a cause of action directly against a host State.

Actions by a host State which could potentially give breach of its commitments to protect foreign investors are particularly prevalent in

[25] The Argentinian policy introduced during the 2001–2002 financial crisis, which unpegged the peso from the US dollar, resulted in an immediate and drastic devaluation of the peso. Among its many different effects, this policy caused the value of foreign investors' peso-denominated concession contracts substantially to shrink.

[26] *Hochtief Aktiengesellschaft v Argentine Republic*, ICSID Case No ARB/07/31, Decision on Liability, 29 December 2014.

[27] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010.

[28] *Tulip Real Estate and Development Netherlands BV v Republic of Turkey*, ICSID Case No ARB/11/28, Award, 10 March 2014.

large international construction projects, which rely to a significant extent on official consent, regulations and approvals. It is for this reason that international developers, contractors and other investors commencing projects in a foreign State are increasingly advised to structure their investments to benefit from available treaty protections, by, for example, routing their investments through project entities in third States which have entered into BITs with the host State, or by ensuring that the investment itself would qualify as a protected investment under a relevant treaty. These issues are discussed further below.

QUALIFYING "INVESTORS" UNDER A BIT

As noted above, not all investors or investments would automatically benefit from the protections offered in a BIT. The gateway jurisdictional issues for any claim brought under a BIT require both that the investor qualifies as a defined "investor" from its home State, which is a question of jurisdiction *rationae personae*, and that the investor's project in the host State qualifies as an "investment" under the applicable BIT, a question of jurisdiction *rationae materiae*. If the conditions for "investors" and "investments" under the BIT are not met, the host State has no obligation to extend the benefits of treaty protection to the project.

In general, investment treaties define investors as persons of a State party to the treaty, other than the State where the investment takes place. Typically, this includes a juridical person (i.e. a company) incorporated in the investor's home State. While simple incorporation may be sufficient for certain home States, other States may require their BITs to define the term "investor" more strictly, for example also requiring a company to have its seat in the relevant home State and/or to carry out certain activities there in order to qualify as an investor of the home State.

These issues are best illustrated by examples. A State which has often not placed strict limits on the criteria for its qualifying investors is the Netherlands. Many Dutch BITs require only that an entity be incorporated within the jurisdiction to benefit from BIT protection. For example, the Netherlands–Czech BIT defines Dutch investors to be simply "legal persons constituted under the laws of [the Netherlands]".[29] A non-Dutch developer seeking to establish a project in the Czech Republic may benefit from the BIT's protections by incorporating, and then routing its investment through a Dutch special purpose project entity. Arbitral tribunals have accepted such project structuring where the relevant BIT wording is not limiting, refusing to pierce the corporate veil to look behind the shell company to

[29] Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, Article 1(b)(ii).

the ultimate nationality of the investor. For example, the tribunal in *Saluka v Czech Republic* found that the claimant, while "in reality a mere shell company", was nevertheless a Dutch company for the purposes of qualifying as an investor under the Netherlands–Czech BIT.[30] In contrast, other States prefer that only entities with genuine commercial activity within their territory may benefit from protective rights offered by other State parties to their investors. For instance, Switzerland has entered into a number of BITs requiring Swiss investors to exercise "real economic activity" on Swiss territory. The Egypt–Switzerland BIT defines investors to be "companies, corporations, business associations and other organisations, which are constituted or otherwise duly organised under the law of that Contracting Party and have their statutory seat, together with real economic activities, in the territory of the same Contracting Party."[31] A contractor routing project investments through a special project vehicle incorporated in Switzerland for tax purposes but without any real Swiss operations would not benefit from investment protection under such BITs.

These gateway issues of jurisdiction *rationae personae* arise regularly in international arbitrations involving construction projects. At its most straightforward, a number of disputes have been filed where the investor is originally a national of a State which already has a BIT with the host State, so no investment structuring is necessary. For example, in *Toto Construzioni v Lebanon*[32] an Italian highway contractor directly brought an investment treaty arbitration against Lebanon for breaches under the Italy–Lebanon BIT. In this case, the Italy-Lebanon BIT required Italian investors to have their head office in Italy in order to qualify for protection under the treaty, a criteria which was met in any event.

Alternatively, an investor may route its investment via a different State which has a BIT with the host State, for example, where the investor's home State has no BIT with the host, or in order to obtain protections from a more favourable BIT than would otherwise be available for a direct investment. In this regard, investment structuring has been likened to corporate structuring to benefit from countries with more favourable tax regimes. In principle, investment structuring is not prohibited under international investment law, and it has been accepted that "[a] party may seek its legal protection under any scheme provided by the laws of the host country".[33] To achieve this, for example, a main contractor could channel its project funds and its investments into the host State via a foreign company or investment vehicle established in a third State, although the

[30] *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paragraphs 240–241.

[31] See, e.g., Agreement Between the Swiss Confederation and the Arab Republic of Egypt on the Promotion and Reciprocal Protection of Investments signed on 7 June 2010, Article 1(2)(b).

[32] *Toto Costruzioni Generali SpA v Republic of Lebanon*, ICSID Case No ARB/07/12, Award, 7 June 2012.

[33] *CME Czech Republic BV v The Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, paragraph 419.

extent to which a BIT protects indirect investments structured through third States will depend on the terms of the treaty (see also below for a discussion of treaty protections offered to shareholder investors). This principle may even be taken advantage of by a prudent developer investing domestically within its own jurisdiction, by routing its investments out of the jurisdiction and back in via an entity established in another State in order to qualify as a foreign investor of that other State, provided however the BIT between the other State and the host State does not prohibit this. In *Alpha Projektholding v Ukraine*,[34] a joint venture project involving a hotel in Ukraine, one of the joint venture partner entities was held to be a qualifying Austrian "investor" under the Austria–Ukraine BIT because it invested via an Austrian investment vehicle, although that entity was ultimately owned by Ukrainian nationals who would not have obtained BIT protection had they simply carried out a domestic investment within Ukraine. The *Alpha Projektholding* Tribunal upheld the principle (which it found was established in earlier awards[35]) that, if Austria and Ukraine had intended to prevent Ukrainian nationals from taking advantage of the protections offered by Austria in the BIT, then the States would have included provisions to this effect, which they had not done.[36]

Although preferable to do so, structuring an investment to take advantage of the matrix of applicable investment treaties with the host State does not necessarily need to be completed before the investment is made. The general view taken by commentators has been summarised as follows:

> "… [t]he validity of nationality planning [is] primarily dependent on the time of the restructuring in relation to the dispute. If the restructuring was undertaken early i.e. before the outbreak of the dispute, the newly acquired nationality will be honoured. But a last minute change of nationality in the face of an existing dispute will be rejected."[37]

The jurisprudence confirms that the determinative factor to assess whether restructuring of investments or corporate re-organisation to change nationality allows a claimant investor to benefit from specific BIT protections is the timing of the crystallisation of the first elements of disputes. Where a restructuring exercise takes place after the investment is made, generally the foreign investor is not protected from a host State's actions which were already pending at the time of the restructuring, although the investor may be protected with respect to State actions taken after the restructuring has

[34] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010.

[35] See, e.g., *Tokios Tokelés v Ukraine*, ICSID Case No ARB/02/18, Decision on Jurisdiction, 29 April 2004, where Ukrainian investors routed their investment through a Lithuanian investment vehicle back into Ukraine, and thereby gained protection from the Lithuania–Ukraine BIT.

[36] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010, paragraph 342.

[37] Inna Uchkunova, "Drawing a Line: Corporate Restructuring and Treaty Shopping in ICSID Arbitration", Kluwer Arbitration Blog, 6 March 2013, citing Christoph Schreuer, "Nationality Planning", Fordham Conference, 27 April 2012, London.

taken place. In *Mobil v Venezuela*,[38] after the initial investment was made the claimants restructured to include a Dutch entity in order to benefit from the Netherlands–Venezuela BIT, under which the arbitration proceedings were later initiated. The tribunal held that "pending disputes"[39] relating to royalties and income tax already existed at the time the claimants restructured their investment, and thus declined jurisdiction under the Netherlands–Venezuela BIT over disputes arising from these pre-existing actions. However, the tribunal accepted jurisdiction in relation to disputes arising from measures which were taken subsequent to the restructuring, because "the dispute over such […] measures can only be deemed to have arisen after the measures were taken", which was after the restructuring. The tribunal noted that the claimants' aim of restructuring their investments to gain BIT protection was a "perfectly legitimate goal as far as it concerned *future disputes*"[40] while the restructuring of investments to gain protection for pre-existing disputes would be "an abusive manipulation of the system of international investment protection."[41]

This would suggest that the foreseeability of the measures complained of by the claimant is thus also a relevant consideration. The *Aguas del Tunari v Bolivia*[42] Tribunal held that the investor could not have contemplated the events leading to the termination of its concession because they occurred after the investor completed its restructuring, which was therefore not abusive, and the jurisdictional objection was dismissed. Other tribunals have also assessed whether a claimant's restructuring of an existing investment was undertaken for abusive or legitimate reasons by examining other facts apart from the timing of the restructuring. For example, the tribunal in *ConocoPhillips v Venezuela*[43] placed significant weight on the fact that (among other issues) the claimants invested over US$400 million after they had restructured the nationality of their investment, finding that "this continued substantial involvement in the development and operation of the projects is evidence telling strongly against any finding of treaty abuse",[44] and therefore rejected Venezuela's jurisdictional objection that the restructuring was impermissible.

[38] *Mobil Corporation, Venezuela Holdings BV et al v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27, Decision on Jurisdiction, 10 June 2010.

[39] *Mobil Corporation, Venezuela Holdings BV et al v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27, Decision on Jurisdiction, 10 June 2010, paragraph 203.

[40] *Mobil Corporation, Venezuela Holdings BV et al v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27, Decision on Jurisdiction, 10 June 2010, paragraph 204, emphasis added.

[41] *Mobil Corporation, Venezuela Holdings BV et al v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27, Decision on Jurisdiction, 10 June 2010, paragraph 205, citing *Phoenix Action Ltd v Czech Republic*, ICSID Case No ARB/06/5, Award, 15 April 2009, paragraph 144.

[42] *Aguas del Tunari SA v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005, paragraph 329.

[43] *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30, Decision on Jurisdiction and Merits, 3 September 2013.

[44] *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30, Decision on Jurisdiction and Merits, 3 September 2013, paragraph 280.

Once an investor has been found to meet the gateway qualification of an "investor" for the purposes of international investment law, whether directly by reliance on its home State's treaty matrix or indirectly by way of reliance on an entity based in a third State, the capital invested in the project itself would need to be assessed as to whether it meets the gateway criteria for qualification as an "investment" pursuant to the relevant treaty.

QUALIFYING "INVESTMENTS" UNDER AN INVESTMENT TREATY

In addition to defining qualifying "investors", investment treaties usually contain definitions of the types of investments which would qualify for treaty protection by the host State. Typically, the definition of "investment" is a non-exhaustive list of assets and includes both tangible and intangible property. However, a BIT may also impose conditions, such as the requirement that an investment must be approved by the host State, or must have certain characteristics, such as the commitment of capital or other resources.

The range of qualifying investments listed in most BITs is generally extremely wide, and would include movable and immovable properties, rights over property (e.g. leases), shares, stocks and bonds, security interests, rights to future income, intellectual property, and licenses and concessions (e.g. to construct and operate an infrastructure project). For example, the US Model BIT defines the term investment as:

> "[…] every asset that an investor owns or controls directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:
> (a) an enterprise;
> (b) shares, stock, and other forms of equity participation in an enterprise;
> (c) bonds, debentures, other debt instruments, and loans;
> (d) futures, options, and other derivatives;
> (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;
> (f) intellectual property rights;
> (g) licenses, authorisations, permits, and similar rights conferred pursuant to domestic law; and
> (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens and pledges."[45]

While a model BIT provides the starting point for further inter-State negotiations on treaty provisions, executed BITs usually contain very similar, and occasionally identical, wide definitions of investment.[46]

[45] 2012 US Model BIT, Article 1.

[46] For example, Article I of the Agreement on economic cooperation between the Government of the Kingdom of the Netherlands and the Government of the Republic of Singapore defines an investment as: "every kind of asset, in particular: (a) movable and immovable property as well as any other rights

The wide scope of such provisions would generally encompass most types of investments in international construction projects, but this is a question of fact and varies from case to case. In the construction sector, arbitral tribunals have held that risk-bearing activities at various stages of a project may be investments qualifying for host State protection. These include activities such as: a contract for the construction of a highway;[47] the purchase by the contractor of shares in a local construction consortium;[48] the grant of a long-term concession by a host State which "could have generated significant returns", despite the contractor not yet having made significant contributions;[49] a contractor's provision of know-how, equipment and personnel to a project, as well as the contractor incurring significant bank charges for providing bank guarantees equivalent to the value of the employer's advance payment;[50] a contractor's supply of services and materials, and the mobilisation of its resources for the performance of a construction contract;[51] an operator's two-year commitment to provide vessels and services for a dredging contract;[52] and a project company's claim to a share of profits or returns flowing from the right to operate a project following its construction.[53]

The assessment of whether an investment would qualify as a protected investment pursuant to a BIT usually takes account of two separate characteristics: the investment's legal nature, and its economic nature. A qualifying investment should possess both the requisite legal and economic characteristics.[54]

The legal characterisation of an investment would include the requirement of a territorial connection with the host State such that the investment falls within its domestic jurisdiction – whether by physical location of tangible property or by legal situs for intangible property rights (e.g. shares).[55] The

in rem; (b) shares or other kinds of interests in companies; (c) title to money or to any performance, such as goodwill, having an economic value; (d) rights in the fields of intellectual property, technical processes and know-how; and (e) such business concessions under public law, including concessions regarding the prospecting for, or the extraction or the winning of natural resources, which give to their holders a legal position of some duration."

[47] *Salini Costruttori SpA and Italstrade SpA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction, 31 July 2001.

[48] *Hochtief Aktiengesellschaft v Argentine Republic*, ICSID Case No ARB/07/31, Decision on Jurisdiction, 24 October 2011.

[49] *Malicorp Ltd v Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award, 7 February 2011, paragraph 111.

[50] *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29, Decision on Jurisdiction, 14 November 2005.

[51] *Pantechniki SA Contractors & Engineers v Republic of Albania*, ICSID Case No ARB/07/21, Award, 30 July 2009.

[52] *Jan de Nul NV and Dredging International NV v Arab Republic of Egypt*, ICSID Case No ARB/04/13, Award, 6 November 2008.

[53] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010.

[54] Zachary Douglas, *The International Law of Investment Claims*, 2009, Cambridge University Press, p 163.

[55] Zachary Douglas, *The International Law of Investment Claims*, 2009, Cambridge University Press, p 172.

precise nature of property rights differs between jurisdictions. Whether or not a particular investment properly falls within the investment definition of the BIT and/or falls within the list of assets and properties considered an investment under the BIT, and thus would be a qualifying investment under the treaty, would be determined by the domestic law of the host State. In this respect, there may be differences between, for example, civil and common law jurisdictions which could ultimately impact on whether an investment qualifies for protection.

The *Alpha Projektholding v Ukraine*[56] Tribunal held that, contrary to the respondent's contentions that Alpha's alleged investment consisted merely of a combination of loan agreements and construction contracts that should not benefit from treaty protection, the agreements relating to the hotel development and management project were a network of agreements that were part of a multi-faceted project, with mutual rights and obligations that in total went far beyond a mere construction contract or loan arrangement. It agreed with the claimant that it was engaged in a complex project for the renovation of a hotel over many years which involved different types of agreements and recalled that, in addition to significant monetary contributions, the investor spent considerable time and effort in advancing the standing and quality of the hotel. The tribunal thus concluded that the claimant had entered into the arrangements in question with the expectation of receiving an economic return that went beyond the mere repayment of the money it had contributed. Although it held that the claimant's investment amounted to more than mere loan agreements, the tribunal also stated obiter that loan agreements, such as those regularly undertaken in relation to large infrastructure projects, can, under proper circumstances, qualify as a protected investment.[57]

Some BITs contain clauses explicitly requiring investments to be made in accordance with the host State's local law or to comply with a specific requirement of the local law, such as the approval process for an investment license. It is generally considered that the failure by a foreign investor to comply with such a provision deprives a tribunal of its jurisdiction. By contrast, when such a provision is not expressly included in a treaty, tribunals generally treat compliance of an investment with host State law as an implied obligation that is, however, assessed not as a jurisdictional gateway issue but as a question of admissibility at the merits stage. Local law compliance is expressed in a number of ways in BITs. For example, in order to benefit from the protection of most BITs concluded with Iran, foreign investors must obtain an investment license from the relevant Iranian investment authority and all foreign investments must be made in

[56] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010, paragraphs 268 to 272.

[57] *Alpha Projektholding GmbH v Ukraine*, ICSID Case No ARB/07/16, Award, 8 November 2010, paragraphs 265 to 274.

accordance with the laws and regulations of Iran. Similarly, all of China's BITs entered into prior to the mid-1990s require investments to be made "in accordance with the laws and regulations" of the host State. (Some of China's more recent BITs, however, no longer contain this type of wording, which may indicate a change to the Chinese policy of strict control over incoming investments.) The local law of Equatorial Guinea requires that qualifying investments are to be reflected in a binding contract between the State and the investor. In the recent case of *Grupo Francisco Hernando v Equatorial Guinea*,[58] the tribunal held that the claimant, a Spanish contractor, did not have a binding contract with the State and, therefore, was unable to meet the criteria for a qualifying investment, and the tribunal declined jurisdiction.

The presence of the necessary legal characteristics is not, however, sufficient for an asset to be considered a qualifying investment – something more is required, which arises out of the fundamental purpose of investment treaties for the promotion of cross-border investments. This characteristic relates to the economic nature of an investment. While the scope and content of this characteristic may be contentious, it is generally accepted that the investment's economic nature is to be assessed to determine whether it would be a qualifying investment. This is because, as one commentator neatly suggests, the purchase of a metro ticket would conform to all the necessary legal characteristics but would not, and of course should not, be protected as an "investment" by a treaty intended to promote cross-border trade and investment.[59]

The classical test of the economic nature of an investment was first expressed by the tribunal in *Salini v Morocco*[60] in relation to a dispute concerning the construction of a highway, which gave rise to the so-called "Salini criteria". These provided that a qualifying investment should possess the interdependent criteria of a substantial contribution, a certain duration of performance of the contract, a participation in the risks of the transaction, and a contribution to the host State's economic development. Other tribunals have subsequently put more emphasis on a more flexible and pragmatic approach, taking into account the Salini criteria but also the circumstances of the case[61] – an approach that often led to the disregard of the investment's contribution to the development of the host State.[62] There is a general consensus among tribunals and international scholars that, while

[58] *Grupo Franciso Hernando Contrearas SA v Equatorial Guinea*, ICSID Case No ARB(AF)/12/2, Award 4 December 2015.

[59] Zachary Douglas, *The International Law of Investment Claims*, 2009, Cambridge University Press, p 163.

[60] S*alini Costruttori SpA and Italstrade SpA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction, 31 July 2001, paragraph 52.

[61] *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No ARB/05/22, Award, 24 July 2008, paragraph 316.

[62] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, pp 70–72.

the Salini criteria are not a defined list which would, if met, automatically achieve qualifying status,[63] the economic nature of the investment should be assessed in accordance with the fundamental purpose of investment treaties which is to encourage inward investment. Generally, the economic nature of the investment is assessed through the prism of the commitment of the investor's resources to the host State, and its assumption of risk in the expectation of returns.[64] This has resulted in tribunals refusing to make a finding of "investment" in cases where, for example, the investor had concluded contracts with a State entity held to be short contracts of limited duration on a commercial basis,[65] or where the alleged investment related to deliveries of wheat over a period of five months.[66]

The tribunal in *Malicorp v Egypt*[67] for instance considered a contribution to the host State to be a necessary requirement for the existence of an investment but held that, although the concession contract between the investor and the host State ended very rapidly without the concessionaire having actually made any significant contributions, the investor did incur expenses in preparing its bid and negotiating the contract and that, moreover, being bound by the concession contract implied an obligation to make major contributions in the future. In the Tribunal's view, this "commitment [constituted] the investment".[68] In a recent jurisdictional award, a tribunal in *İckale v Turkmenistan*[69] held that "the Tribunal's determination of whether an investment has been made in the present case does not turn on the precise value of the Contracts or the amount of the Claimant's expenditures, but rather on whether the Claimant made a capital contribution to the venture in question," and the tribunal found that, on the facts, the claimant contractor had made a qualifying investment by establishing a branch office within the jurisdiction, engaging substantial construction projects and committing its own assets to the project including its own money, machinery and equipment.[70]

To take the earlier example of the purchase of a metro ticket, the assessment of an investment's economic characterisation may be seen as a threshold

[63] See, e.g., *Malaysian Historical Salvors, SDN, BHD v Government of Malaysia*, ICSID Case No ARB/05/10; *Malaysian Historical Salvors, SDN, BHD v Government of Malaysia*, ICSID Case No ARB/05/10, Award on Jurisdiction, 17 May 2007, paragraph 106(e).

[64] Zachary Douglas, *The International Law of Investment Claims*, 2009, Cambridge University Press, p 189.

[65] *Global Trading Resource Corp and Globex International Inc v Ukraine*, ICSID Case No ARB/09/11, Award, 1 December 2010, paragraphs 44 and 57.

[66] *Romak SA (Switzerland) v The Republic of Uzbekistan*, UNCITRAL, PCA Case No AA280, Award, 26 November 2009, paragraph 242.

[67] *Malicorp Ltd v Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award, 7 February 2011.

[68] *Malicorp Ltd v Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award, 7 February 2011, paragraph 113.

[69] *İckale İnsaat Ltd Sirketi v Turkmenistan*, ICSID Case No ARB/10/24.

[70] *İckale İnsaat Ltd Sirketi v Turkmenistan*, ICSID Case No ARB/10/24, Award, 8 March 2016, paragraph 293.

without which the investment would not qualify for treaty protection. While economic characteristics may potentially be relevant for the assessment of whether certain types of specialist investments would qualify for protection under an investment treaty (e.g. loans, bonds, financial instruments, etc.), the large long-term capital-intensive investments in infrastructure and construction would generally be classified as protected investments in any event without the need for a review of their economic character. It is, however, not always straightforward to determine whether an investor's capital expenditure in construction projects would qualify as a protected investment.

"Pre-investment" expenditures incurred before a formal contract is entered into commonly occur in international construction projects. High pre-investment costs are common in the construction industry and "[construction] investors spend several million dollars on financing, negotiating, engineering, legal work, environmental studies and financial advisory studies" and other pre-investment analysis.[71] The expenditure of pre-contractual costs for financing, feasibility studies, expert analyses, financial or environmental due diligence, or preparatory reports is of course not a new trend; already in 1975 a FIDIC report noted that "substantial pre-investment analysis is usually required prior to [the] owner's decision to proceed with [the] design and construction of a project".[72] Often, such costs will be incurred by the contractor on the strength of a letter of intent or a similar pre-contractual arrangement with the employer. A letter of intent is typically expressed not to be binding[73] but is based on the shared understanding that the parties intend to negotiate and execute a contract and that, meanwhile, the contractor should commence the project preparations and incur costs in doing so. In the event that a final contract is ultimately not entered into, there is uncertainty as to whether the costs incurred on the basis of the letter constitute a qualifying investment as defined by a BIT, whether they would allow the investor and its project to benefit from treaty protection, and thus whether an action could be brought pursuant to the BIT to recover these preliminary costs. One tribunal has

[71] Walid Ben Hamid, "The *Mihaly v Sri Lanka* Case: Some Thoughts Relating to the Status of Pre-investment Expenditure" in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, Cameron May, pp 50–51.

[72] FIDIC, The Role of the Consulting Engineer in Projects, May 1975 (reprint November 1983), p 5, cited in Walid Ben Hamid, "The *Mihaly v Sri Lanka* Case: Some Thoughts Relating to the Status of Pre-investment Expenditure" in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, Cameron May, pp 50–51.

[73] The extent to which parties can be bound by letters of intent are a function of the governing law. In French law, pursuant to the general obligation of good faith, letters of intent would typically oblige the parties to enter into and pursue negotiations in good faith, and thus any wrongful termination of negotiations in bad faith may give rise to a potential liability under the letter of intent. In English law, the binding nature of a letter of intent is discerned from its terms, and English courts will generally not infer binding obligations where a document is expressed to be non-binding.

directly observed that the question of whether pre-investment activities merit treaty protection is "debatable".[74]

The tribunal in *Nordzucker v Poland*[75] explained the policy reason behind excluding pre-investment expenditures from available investment protection, which is to prevent unsuccessful bidders from pursuing frivolous claims:

> "It is not surprising that the host States that waive a part of their sovereign rights by their agreement to arbitrate the disputes concerning the investments made and admitted in accordance with their legislation do not agree to arbitration of disputes related to pre-investment relations with persons merely intending to invest. Taking into account the fact that tenders open for privatization of State's assets [...] attract usually a large number of foreign bidders only one of whom can be successful, the State would be exposed to many international arbitration proceedings commenced by unsuccessful bidders. For this reason the States in principle [...] agree to grant the full Treaty protection only with regard to investments actually made and admitted in accordance with the law of the host State and not to intended investments."[76]

On the one hand, most treaties are silent on whether investment protection is specifically extended to the cost of establishment or other pre-investment expenditure. In such cases, the question of whether or not pre-investment expenditure would benefit from treaty protection is uncertain and would fall to be determined by a tribunal. The jurisprudence would suggest that in certain circumstances such costs would not give rise to a protected investment, as discussed below. This gives rise to a potentially significant risk factor for a contractor faced with a decision to commence preparatory operations on the basis of a non-binding letter of intent.

On the other hand, a minority of investment treaties are intended to extend protections to certain types of preliminary expenditures which could arguably be interpreted as "pre-investment". For example, Article 1102(1) of the North American Free Trade Agreement ("NAFTA") provides:

> "Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the *establishment, acquisition*, expansion, management, conduct, operation, and sale or other disposition of investments." (emphasis added)

Article 1103(1) of the NAFTA provides:

> "Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the *establishment, acquisition*, expansion, management, conduct, operation, and sale or other disposition of investments." (emphasis added)

[74] *Joseph C Lemire v Ukraine*, ICSID Case No ARB/06/18, Decision on Jurisdiction and Liability, 21 January 2010, paragraph 89. The tribunal did not analyse the issue further, however, as it found that the activities in question arose out of investments which had already been made.

[75] *Nordzucker AG v Republic of Poland*, UNCITRAL, Partial Award, 10 December 2008.

[76] *Nordzucker AG v Republic of Poland*, UNCITRAL, Partial Award, 10 December 2008, paragraph 189.

Further, the NAFTA definition of "investor" includes an entity which merely "seeks … to make an investment".[77] Arguably, these provisions would allow pre-investment expenditures to benefit from NAFTA protection on the basis that this protection arises from the specific extension of the protections available to the "investment" to cover also the preliminary stages of its "establishment" and "acquisition".

A review of the existing case law suggests that such expenditures generally do not constitute a protected investment and are not recoverable, although there are only a few awards that have addressed the issue and there is no clear trend. In the case of *Mihaly v Sri Lanka*,[78] the US claimant brought a claim against Sri Lanka under the Sri Lanka–US. BIT in relation to the development of a 300 megawatt power station project. The government of Sri Lanka had selected the claimant from a number of interested investors and had entered into exclusive negotiations with it for the conclusion of a final agreement. During these negotiations the parties signed a letter of intent, a letter of agreement and a letter of extension which were all expressed to be non-binding. The claimant then incurred significant expenses in establishing a project company, negotiating project documents and arranging finance, but the project ultimately failed and no final agreement was signed. The claimant instituted arbitration proceedings seeking reimbursement of its expenditures, as well as the lost profits which would have been earned from the abandoned project.

The tribunal declined jurisdiction on the basis that the pre-investment expenditures did not constitute a protected investment. The tribunal took account of the fact that no final contract was concluded, and, in particular, that all signed documents throughout the negotiations contained specific language about their non-binding effect. It noted that a "crucial and essential feature of what occurred between the claimant and the respondent" was that "none of the documents, in conferring exclusivity upon the claimant, created a contractual obligation for the building, ownership and operation of the power station. Second, the grant of exclusivity never matured into a contract."[79] The tribunal held that the test to establish whether expenditures were recoverable was whether the parties themselves had accepted the expenditures as "investment":

> "Ultimately, it is always a matter for the parties to determine at what point in their negotiations they wish to engage the provisions of the Convention by entering into an investment. […] The Respondent clearly signalled, in the various documents which are relied upon by the Claimant, that it was not until the execution of a contract that

[77] NAFTA, Article 1138.

[78] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award, 15 March 2002.

[79] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award, 15 March 2002, paragraph 48.

it was willing to accept that contractual relations had been entered into and that an investment had been made."[80]

The tribunal emphasised, however, that its findings were case-specific and that "in other circumstances, similar expenditure may perhaps be described as an investment."[81] The tribunal also noted that, if the parties had ultimately entered into a contract, it was open to them to agree that "the moneys expended during the period of negotiations might have been capitalised as part of the cost of the project and thereby become part of the investment. By capitalising expenses incurred during the negotiation phase, the parties in a sense may retrospectively sweep those costs within the umbrella of an investment."[82] In other words, it was open to the parties to agree that the employer would reimburse the contractor for pre-investment expenditures, and, if so, then those costs would form part of the "investment" for the purposes of the BIT. This finding does not progress the matter much further, however, since the tribunal's lack of jurisdiction over pre-investment expenditure arose precisely because no agreement was reached between the employer and the contractor and the tribunal found that no "investment" was made because of the absence of any such agreement. A concurring separate opinion by one arbitrator noted that the tribunal's rejection of jurisdiction "would be different if the Claimant could have demonstrated that the expenditures had been incurred by a Sri Lankan company in which it had a share",[83] in other words if the claimant was a shareholder in a local company,[84] but on the facts the claimant had never purchased any such shares.

The tribunal in *Zhinvali v Georgia*[85] relied on the *Mihaly* reasoning to hold that pre-investment expenditures were not recoverable. The claimant, an Irish company, filed a claim against Georgia under the State's local investment law in relation to the rehabilitation of a hydro-electric power plant and its tailrace tunnel. After negotiating for three years with the government, Zhinvali was excluded from the project and no agreement was signed. The claimant instituted arbitration proceedings seeking reimbursement for its expenditures incurred during the negotiations for feasibility studies, consultancy costs, travel expenses and legal fees. The tribunal ruled that

[80] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka,* ICSID Case No ARB/00/2, Award, 15 March 2002, paragraphs 51 and 60–61.

[81] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award, 15 March 2002, paragraph 49.

[82] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award, 15 March 2002, paragraph 50.

[83] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Concurring Opinion of Mr David Suratgar, paragraph 8.

[84] In this regard, see discussion above regarding shareholders.

[85] *Zhinvali Development Ltd v Republic of Georgia,* ICSID Case No ARB/00/1, Unreported, as commented on in Walid Ben Hamid, "The *Mihaly v Sri Lanka* Case: Some Thoughts Relating to the Status of Pre-investment Expenditure" in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, Cameron May, pp 67–70.

the pre-investment expenditures did not qualify as protected investment because there was no explicit or implicit consent by Georgia to treat the expenditure as an investment, as required in the domestic investment law.[86]

The tribunal in *William Nagel v Czech Republic*[87] also held that pre-investment expenditure was not recoverable. Mr Nagel, a British national, brought arbitration proceedings against the Czech Republic in relation to the rights he had acquired through a cooperation agreement concluded with the host State's telecommunications company. Mr Nagel and the company had negotiated a cooperation agreement, and he sought to obtain the necessary licences and permits to operate a mobile telephone network. The Czech authorities held a public tender for two contracts, neither of which was awarded to Mr Nagel. He instituted proceedings arguing that his rights under the cooperation agreement constituted "*claims to money or to any performance under contract having a financial value*" under the applicable BIT. According to the tribunal, in order for Mr. Nigel's rights to be protected, they had to have a "financial value". The tribunal determined that the criteria for financial value are two-fold: (i) the value must be real rather than just potential;[88] and (ii) the value is determined by reference to domestic law because "value is […] the effect of legal rules which create rights and give protection to them".[89] Proceeding then to analyse the rights acquired by Mr Nagel under the cooperation agreement, the tribunal decided that they did not have a financial value under Czech law, and consequently did not constitute recoverable expenditures.

Taking a slightly different approach, the tribunal in *PSEG v Turkey*[90] held that the investor had made a qualifying investment and that *some* of its pre-investment expenditures were recoverable, on the basis of the parties having entered into an initial binding agreement. The US claimants filed a claim against Turkey under the Turkey–US. BIT in relation to an authorisation to conduct a feasibility study into the construction of a coal-fired power plant. Two years after the government had granted the authorisation to the claimants, the parties signed a concession contract on the basic construction parameters but subsequently disagreed on the specific terms of the contract, which led to the failure of the project before any construction took place. Turkey argued that the failure to agree on specific terms prevented the

86 *Zhinvali Development Ltd v Republic of Georgia*, ICSID Case No ARB/00/1, unreported, as commented on in Walid Ben Hamid, "The *Mihaly v Sri Lanka* Case: Some Thoughts Relating to the Status of Pre-investment Expenditure" in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, Cameron May, p 69.

87 *William Nagel v The Czech Republic*, SCC Case No 049/2002, Final Award, 9 September 2003.

88 *William Nagel v The Czech Republic*, SCC Case No 049/2002, Final Award, 9 September 2003, paragraph 299.

89 *William Nagel v The Czech Republic*, SCC Case No 049/2002, Final Award, 9 September 2003, paragraph 300.

90 *PSEG Global Inc, The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Ltd Sirketi v Republic of Turkey*, ICSID Case No ARB/02/5, Decision on Jurisdiction, 4 June 2004, paragraph 104.

pre-investment expenditure, which was incurred during the materialisation of the project under the concession agreement, from qualifying as an "investment". The tribunal held, however, that:

> "a contract is a contract. The Concession Contract exists, is valid and is legally binding. This conclusion is sufficient to establish that the Tribunal has jurisdiction on the basis of an investment having been made in the form of a Concession Contract. A different question, again pertaining to the merits, is whether all or some of the activities undertaken qualify as a part of the investment or are to be regarded as merely preparatory. The same holds true of whether the assets of the Project Company constitute an investment."[91]

After upholding its jurisdiction, the tribunal assessed the merits of the claim. It held that pre-investment expenditures incurred prior to the authorisation of the feasibility study were not recoverable, while those incurred after the authorisation of the feasibility study but prior to the conclusion of the concession contract were recoverable.[92] Although the tribunal's use of the term "pre-investment" expenditures has been criticised,[93] the case is nevertheless interpreted as providing tentative or limited support for the principle of recoverability of expenses incurred prior to the signing of the formal contract but where the host State has approved a particular investment decision.[94]

At the opposite end of the spectrum of the scale of investments in international construction projects is the purchase by foreign shareholders of shares in local entities. In this regard, international investments often take place through the acquisition of shares by foreign investors in a company incorporated in the host State.[95] A project company participating in a JV may be a direct participant and could thus bring a treaty claim, but a claim could also be brought by investors further up the corporate chain, by intermediate or ultimate foreign shareholders of the project company. Many BITs give independent standing to shareholders. In such cases the participation in the company becomes the investment and the shareholders themselves qualify as foreign investors. International investment law allows shareholders to bring claims for reflective loss incurred as a result of injury to the company which they own. This is in marked contrast with most developed systems of national corporate law which prevent shareholders

[91] *PSEG Global Inc, The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Ltd Sirketi v Republic of Turkey*, ICSID Case No ARB/02/5, Award, 19 January 2007, paragraph 305.

[92] *PSEG Global Inc, The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Ltd Sirketi v Republic of Turkey*, ICSID Case No ARB/02/5, Award, 19 January 2007, paragraph 328.

[93] Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law*, 2008, British Institute of International and Comparative Law, pp 275–276.

[94] Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law*, 2008, British Institute of International and Comparative Law, p 276.

[95] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, pp 56–57.

from claiming for losses to the separate companies in which they hold shares, and allow only claims for direct injuries to their rights as shareholders.[96]

This principle presupposes, however, that the definition of "investment" under the relevant BIT includes shareholding or the participation in a company – which, as seen above, is a very common inclusion.[97] It also presupposes that the BIT in question allows for "indirect" investments; it has been held that, unless explicitly excluded, the protection of indirect investments is implied even if it is not expressly mentioned. For instance, in *Siemens v Argentina* there was no explicit reference to direct or indirect investments in the BIT.[98] The tribunal noted that the definition of investment was very broad and included shares and other types of participation in companies and found that "[t]he Treaty does not require that there be no interposed companies between the investment and the ultimate owner of the company".[99] Indirect investments were thus found to be covered by the Treaty.

While some tribunals have limited BIT protection to majority shareholders, others have extended it to minority shares. In addition, there is no principle requiring the shareholding to be held through entities of the same nationality as the claimant. The acceptance of shareholders as investors has been extended to indirect shareholding through an intermediary company incorporated in a third State – thus allowing for the investment structuring through countries providing for a favourable BIT in force with the host State in which the investor wishes to invest, as discussed above.[100] Investment structuring through a third country relies, however, on the relevant BIT not requiring the investor to have its headquarters or real economic activities located in one of the States who are parties to the BIT in question.

A further factor to consider regarding shareholding is whether the treaty requires an investor to have "direct" and/or "indirect" control of an investment. Where a BIT requires "control", a passive shareholder with no possibility of control over a company has no standing to bring a treaty claim, even if owning shares directly. In this regard, control refers to the de facto level of corporate control, usually through voting or other corporate procedures, which can be exerted by the claimant shareholder through the various intermediary entities between it and the investment vehicle. Direct control implies no intermediaries, while indirect control implies that the control of the investor is exerted through one or more intermediaries

[96] See, e.g., David Gaukrodger, "Investment Treaties and Shareholder Claims: Analysis of Treaty Practice", OECD Working Papers on International Investment 2013/14, OECD Publishing, 2014.

[97] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, p 57.

[98] *Siemens AG v The Argentine Republic*, ICSID Case No ARB/02/8, Decision on Jurisdiction, 3 August 2004.

[99] *Siemens AG v The Argentine Republic*, ICSID Case No ARB/02/8, Decision on Jurisdiction, 3 August 2004, paragraph 137.

[100] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, Oxford University Press, Second Edition, 2012, pp 58–59.

between it and the project entity.[101] The test for control is therefore met when one entity "possess[es] the legal capacity to control the other entity", for example by the exercise of voting rights and shareholdings.[102] Accordingly, even where the claimant entity had no majority ownership of shares, "control" could be established if the relevant voting rights were held.[103]

The provisions relating to direct and indirect control, and to majority and minority shareholdings, allow for joint venture partners' respective contributions to complex international construction project partnerships to access investment treaty protection, but only in proportion to each partner's respective share of ownership. For example, where an investment is structured by a number of main contractors based in States A, B and C each establishing their own dedicated foreign investment entities in States J, K and L through which each main contractor purchases a proportion of the shares of the project's JV company incorporated in State Q, and the JV company then in turn purchases the local project company in the host State X, investment treaty claims may be brought at a number of levels provided the relevant treaties exist. This allows for a project structure to be planned to take account of treaties which may exist at the level of the main contractors (i.e. between States X and A/B/C), at the level of dedicated investment entities (i.e. between States X and J/K/L), and also at the level of the joint venture company (i.e. between States X and Q). This structure also allows for multiple configurations of cross-jurisdictional tax planning to be carried out alongside investment treaty structuring.

It can be seen that this gives rise to the possibility for multiple claims being brought against a host State under different BITs in relation to the same project. Parallel proceedings arise where different shareholders or groups of shareholders, often at different levels of ownership, pursue claims against the host State in different fora, with each claim being based on the same set of underlying facts but governed by a different treaty in which the substantive protections may be differently worded. While this may often be advantageous to foreign investors, it can present significant risks for host States. This strategy forces the host State to defend itself on multiple fronts, often facing conflicting or competing litigation strategies. For investors, the existence of parallel proceedings can seem to provide the opportunity to take 'a second bite at the apple': as final shareholder the investor itself could bring a claim against a host State for violating the protections provided by one BIT while the investor's wholly-owned mid-level project company could

[101] *Aguas del Tunari SA v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent's Objection to Jurisdiction, 21 October 2005, paragraph 236.

[102] *Aguas del Tunari SA v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent's Objection to Jurisdiction, 21 October 2005, paragraph 234.

[103] *AIG Capital Partners Inc and CJSC Tema Real Estate Company Ltd v Republic of Kazakhstan*, ICSID Case No ARB/01/6, Award, 7 October 2003, paragraph 9.4.8.

bring a claim against the same host State under a different BIT on the basis of the same facts, with potentially quite divergent results.

Finally, the policy intention to encourage foreign investment may also allow a foreign shareholder or a foreign party to a joint venture project to obtain BIT protections as a foreign investor even if its local partners, as domestic investors, may not benefit from similar protected treatment by the State. The case of *Tulip Real Estate v Turkey*[104] involved the construction of a residential and commercial complex in Turkey. The foreign contractor Tulip Real Estate, a subsidiary of a major European contractor, held 65% of the shares of a local Turkish joint venture company which it had established for the project. Tulip Real Estate brought an arbitration against Turkey by qualifying as an "investor" under the relevant BIT (its claim was limited to the proportional shareholding amount of the alleged damage suffered by the local joint venture company), but Tulip Real Estate's local partners did not qualify for similar rights of recourse against Turkey.

ENSURING A FOREIGN PROJECT IS PROTECTED UNDER A BIT

In order to maximise the potential protections available under BITs, developers, contractors and other foreign investors are generally advised to consider these issues at the early stage of the project planning, ideally before establishing project entities or making fund transfers. In this respect, the approach to investment structuring is broadly similar to the structuring of international investments to maximise tax efficiency. As awareness of the BIT protection regime grows, investment structuring and tax planning exercises are being carried out in tandem. Often, the most favourable jurisdictions for project vehicles may also be those which are both tax efficient and have networks of BITs with other States.

It may also be possible for an investor to take remedial steps to restructure an existing project in order to gain the protections afforded by BITs provided this is done sufficiently early before a dispute arises. An existing project may potentially be re-routed through a new company established in a third State which has entered into a BIT with the host State when a dispute appears on the horizon, although the timing of the restructuring as compared with the crystallisation of the dispute is critical.

Contractors, developers and investors looking to carry out investment protection risk assessments or analyses of existing and planned projects would generally examine some or all of the following questions:

- Is there a BIT in place that the investor and/or the project could benefit from?

[104] *Tulip Real Estate and Development Netherlands BV v Republic of Turkey*, ICSID Case No ARB/11/28, Award, 10 March 2014.

- Are the definitions of "investor" and "investment" met and any conditions under the BIT complied with?
- Does the BIT provide key relevant protections, such as protection from expropriation, fair and equitable treatment, protection from discriminatory or unreasonable treatment, etc.?
- Does the BIT provide the investor with access to international arbitration for claims in respect of all relevant treaty standards? If so, are there procedural conditions that must be complied with before a claim may be made?
- Does the local law of the host State provide any additional protection, or impose limitations or conditions on protection?

Where sufficient treaty protection is not in place, it may be possible to identify whether remedial steps are available which would allow a project to become protected (for example, by restructuring the project investment through a third State). Where limited treaty protection is in place, it can be enhanced by restructuring or similar steps. As the volume of cross-border construction and engineering projects grows, it is becoming common to structure the projects to benefit from foreign investor protections offered by host States, whether this is carried out during the initial planning stage of the project or during the early lifetime of a project before a dispute arises.