

**INVESTMENT AGREEMENT CLAIMS UNDER  
THE 2004 MODEL U.S. BIT: A CHALLENGE  
FOR STATE POLICE POWERS?**

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ABSTRACT

Countering current practice in investment treaty arbitration, the 2004 U.S. Model Bilateral Investment Treaty ("BIT") authorizes investors to raise a claim in investment treaty arbitration using direct recourse arbitration for a breach of a category of contracts called "investment agreements," corresponding to natural resource and public service concessions and infrastructure projects. I analyze the consent clause for investment agreement claim arbitration in the context of the evolution of dispute resolution of transnational contracts between States and investors with particular emphasis on the recent controversy in investment treaty arbitration over contract claims, and discuss some of the implications for States which commit to the investment agreement provisions of the consent clause. A wide range of government administrative actions affecting foreign investment, including non-discriminatory regulations for public welfare purposes, could become forms of compensable liability that are currently not considered to be international wrongdoing under customary international law or in contemporary BIT practice under the investment agreement arbitration consent clause. Given the theoretical problems with the judicial administration of contract claims in treaty arbitration and the potential conflict with States' rights to regulate, particularly in the field of environmental law, I advocate a narrow construction of the investment agreement provisions to reconcile them with customary international law and investment arbitration practice.

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## 1. INTRODUCTION

The question of whether an investor may litigate breaches of concession contracts through investment treaty arbitration has generated heated controversy<sup>1</sup> in treaty arbitration in recent years, echoing a dispute between developed and developing countries over the proper forum for the adjudication of concession agreements for natural resource extraction that stretches back at least a century.<sup>2</sup> The United States has addressed this question quite specifically in the dispute resolution clause of its latest

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<sup>1</sup> See generally Stanimir Alexandrov, *Breaches of Contract and Breaches of Treaty: The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, 5 J. WORLD INVESTMENT & TRADE 557 (2004) (discussing two contradicting holdings reached by the SGS tribunal in deciding whether a tribunal set up by a investment treaty can exercise jurisdiction on breaches of contract claims where there is an umbrella clause); Christopher Schreuer, *Investment Arbitration and Jurisdiction over Contract Claims: the Vivendi I Case Considered*, in INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM ICSID, NAFTA BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW 281, 281–324 (Todd Weiler ed., 2005); Emmanuel Gaillard, *Investment Arbitration and Jurisdiction over Contract Claims: the SGS Cases Considered* in INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM ICSID, NAFTA BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW, *supra*, at 325, 325–46; Jared Wong, *Umbrella Clauses in Bilateral Investment Treaties: of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 135 (2006) (contending that a BIT tribunal has jurisdiction over breach-of-contract claims since the umbrella clause applies to investor-states, and that such a tribunal can exercise such jurisdiction notwithstanding an exclusive forum selection clause designating a different forum); Michael D. Nolan & Edward G. Baldwin, *The Treatment of Contract-Related Claims in Treaty-based Arbitration*, MEALEY'S INT'L ARB. REP., June 2006, at 19 (noticing that many issues still arise as to how tribunals in BIT-based arbitrations will handle private-law contract claims).

<sup>2</sup> See M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 20–24 (2d ed. 2004) (reviewing methods including bilateral treaties that developed in international law to protect foreign investment by multinational corporations and the problems associated with such protections); *North American Dredging Company of Texas (United States) v. Mexico* (1926), 4 REP. INT'L ARB. AWARDS 26 (General Claims Commission 1926) (noting that the legal controversy as to whether contracts with foreign investors may be adjudicated outside of national court systems started in the Americas in the late 19<sup>th</sup> century with the Calvo doctrine, entering into international relations between the developed countries and the Middle East, Asia and Africa mainly after WWII: according to the Calvo doctrine, in matters of host State interference with foreign property, the foreign party must assert a claim in domestic courts under host State laws).

prototype for its Bilateral Investment Treaties (“BITs”) and Investment Chapters of Free Trade Agreements, the U.S. 2004 Model Bilateral Investment Treaty (“the Model BIT”).<sup>3</sup> Already incorporated in nine investment treaty arrangements negotiated by the U.S. beginning with the Singapore FTA<sup>4</sup> in 2002, the dispute resolution clause of the Model BIT (“DRC”),<sup>5</sup> contains specific procedures for the arbitration of certain transnational concession contract claims, procedures that stand to challenge national administrative law systems and impose *de facto* constraints on signatory States’ prerogative to regulate for the health, safety and welfare of their citizens.

Countering the current majority practice disfavoring the arbitration of contract claims as such in investment treaty tribunals, the DRC expressly authorizes qualified investors of the Treaty Parties to raise a claim in investment treaty arbitration for a breach of a category of contracts called “investment agreements,” corresponding to agreements for natural resource and public service concessions and public infrastructure projects. In this Article I analyze the DRC expressing the advance consent of the treaty parties to arbitrate investment agreement claims and discuss some of their implications for States who would commit to the provisions. In view of the theoretical difficulties with arbitrating contract claims in treaty tribunals as well as the barriers these provisions raise to environmental protection in particular, I argue for a narrow interpretation of the provisions based on precedents in investment treaty arbitration and customary international law.

According to the subject matter jurisdiction clause in Article 24 of the DRC, in the event an “investment dispute” cannot be reconciled, a claimant may, “(a) on its own behalf or (b) on behalf of an enterprise . . . that the claimant owns or controls directly or indirectly,” submit a claim “(i) that the respondent has

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<sup>3</sup> Treaty between the Government of the United States of America and the Government of [Country] concerning the encouragement and reciprocal protection investment [hereinafter Model BIT], available at <http://www.state.gov/documents/organization/117601.pdf>.

<sup>4</sup> The counterparty countries are Oman, Singapore, Chile, Uruguay, Rwanda, Colombia, Morocco, Panama, Korea and Peru. The provisions were also incorporated in CAFTA. Dominican Republic—Central America—United States Free Trade Agreement art. 20, Aug. 5, 2004, available at [http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset\\_upload\\_file85\\_3940.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file85_3940.pdf).

<sup>5</sup> See Model BIT, *supra* note 3, Section B.

breached . . . (C) an investment agreement; and (ii) that the enterprise has incurred loss or damage by reason of, or arising out of, that breach . . . .”

As with many modern BITs, the Model BIT authorizes an investor of one treaty party to make a claim directly against the host State of investment in an international arbitration tribunal through the advance expression of consent to such claims by the host State (this is sometimes called direct recourse arbitration or “arbitration without privity”).<sup>6</sup> Such an award is not appealable by national courts. It is subject at most to internal review by the International Centre for Settlement of Investment Disputes (“ICSID”),<sup>7</sup> or it may be challenged at the enforcement stage for limited causes. Recognized within the ambit of the United Nations Convention for the Enforcement and Recognition for Foreign Arbitral Awards (“the New York Convention”)<sup>8</sup> the awards of an

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<sup>6</sup> See Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV.: FOREIGN INVESTMENT L.J. 232, 233 (1995) (“By allowing direct recourse by private complainants with respect to such a wide range of issues, these [multilateral] treaties create a dramatic extension of arbitral jurisdiction in the international realm.”).

<sup>7</sup> See Convention on the Settlement of Investment Disputes Between States and Nationals of Other States art. 52, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention]. When the parties to the dispute choose the ICSID rules for dispute settlement under the treaty, article 52 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“the ICSID Convention”) applies, limiting all forms of review to the ICSID Annulment Procedure, which states that a decision may be annulled if an Ad Hoc Committee finds:

- (a) that the Tribunal was not properly constituted;
- (b) that the Tribunal has manifestly exceeded its powers;
- (c) that there was corruption on the part of a member of the Tribunal;
- (d) that there has been a serious departure from a fundamental rule of procedure; or
- (e) that the award has failed to State the reasons on which it is based.

<sup>8</sup> See Model BIT, *supra* note 3, art. 34.9 (“A disputing party may seek enforcement of an arbitration award under the ICSID Convention or the New York Convention [or the Inter-American Convention] regardless of whether proceedings have been taken under paragraph 8.”); Convention on the Enforcement and Recognition for Foreign Arbitral Awards art. 5, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 (stating that a country may refuse to recognize an award under limited circumstances).

arbitration tribunal founded under the Model BIT must be enforced by the mandate of the treaty.<sup>9</sup> A party may also seek enforcement in the national courts under the convention establishing ICSID.<sup>10</sup>

While the Model BIT and the new treaties based on it are not unique in authorizing the resolution of disputes arising out of contracts in an international tribunal,<sup>11</sup> they are apparently the first to specifically require the settlement of a claim for a breach of a concession contract with an investor under direct recourse arbitration pursuant to a consent clause. Since concession agreements may provide for dispute resolution according to the laws of the host State under its judicial processes, the treaty provisions may allow investors *ex post facto* to circumvent the domestic courts, as though the parties had originally agreed upon international commercial arbitration for the settlement of disputes related to the contract instead. When combined with the general duties for recognition and enforcement of awards in the treaty, the investment agreement claim provisions make the enforcement of the specific obligations in the investment agreement through treaty arbitration an international duty for which money damages is the principal remedy.

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<sup>9</sup> See Model BIT, *supra* note 3, art. 34.7 ("Each Party shall provide for the enforcement of an award in its territory."); *id.* art 37 (discussing state-state dispute settlement).

<sup>10</sup> See Model BIT, *supra* note 3, art. 24.3 ("Provided that six months have elapsed since the events giving rise to the claim, a claimant may submit a claim referred to in paragraph 1 under the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, provided that both the respondent and the non-disputing Party are parties to the ICSID Convention.").

<sup>11</sup> See, e.g., Declaration of the Government of the Democratic and Popular Republic of Algeria, 1 Iran-U.S. Cl. Trib. Rep. 3 (1981); Declaration of the Government of the Democratic and Popular Republic of Algeria concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran art. 2, sec. 1, 1 Iran-U.S. Cl. Trib. Rep. 9 (1981). Collectively called the Algiers Accord, these conventions created the Iran-United States Claims Tribunal and vested the tribunal with jurisdiction to deal with disputes arising over contracts. However, the contracts to be resolved under the treaty were those for which the parties were either both private entities or both governments. Thus, when a State party was involved in a dispute with an alien of another country concerning a contract, the claims alleged expropriation under international law with contractual rights as the object of expropriation, rather than breach of contract as such.

As treaty tribunals have declined to make awards solely on the basis of the breach of a State contract<sup>12</sup> to this point,<sup>13</sup> the investment agreement claims provisions create an entirely new remedy in investment treaty arbitration, one that has strong potential to conflict with the normal regulatory and administrative functions in the areas of public contracting, environmental regulation and the disposition of natural resources of host States. The prospective clash with host State administrative law originates in the open-ended language of the consent clause including the award clause,<sup>14</sup> that could impose compensable liability on a much wider range of State conduct than in either current investment treaty claims or international law claims arising from the discriminatory breach of contract with an alien. Under a broad interpretation yet one that is not far from the plain meaning of the text, unanticipated non-discriminatory regulation of the host State for legitimate public purposes would require financial compensation to the investor for any compliance costs incidentally incurred to an investment under the concession contract, extending potentially to foregone profits.<sup>15</sup> Investors would not need to demonstrate conduct that amounted to a violation of customary international law or the treaty to obtain relief. In addition, if the investment agreement contains a stabilization clause, host States could face much tighter constraints in policy and be more frequently obliged to compensate for regulation.<sup>16</sup> Faced with such

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<sup>12</sup> I take State contract to mean a contract between a State and an alien investor in the general sense.

<sup>13</sup> *But see* *Eureko B.V. v. Republic of Poland* (Neth. v. Pol.), Partial Award and Dissenting Opinion, para. 262, 12 ICSID (W. Bank) 335 (2005) (granting plaintiff remedy on the grounds that Poland had breached its contractual duties under the investment agreement). This is the only case I know of in which a breach of contract was deemed an independent cause for compensation in an investment treaty arbitration. The breach of a contract was deemed a breach of the treaty's umbrella clause and consequently was found to be a compensable breach of the treaty. However, no decision on the measure of damages was rendered and annulment has been applied for. *See* the Agreement on Encouragement and Reciprocal Protection of Investments, Neth.-Pol., Sept. 7, 1992, 2240 U.N.T.S. 387 for specific provisions of the treaty.

<sup>14</sup> *See infra* Section 4.1.

<sup>15</sup> *Id.*

<sup>16</sup> *See* discussion *infra* Section 2.3; Lorenzo Cotula, *Regulatory Takings, Stabilization Clauses and Sustainable Development* (March 27-28, 2008) (paper submitted for the OECD Global Forum on International Investment VII), *available at* <http://www.oecd.org/dataoecd/45/8/40311122.pdf> ("Compared to

legal sanctions arising from these treaty commitments, developing countries I argue will rationally opt to forego promulgating or enforcing environmental and social legislation applying to investment agreements to the detriment of environmental governance and sustainable development.

The introduction of contract claim arbitration into treaty tribunals raises many theoretical difficulties from the point of view of judicial administration as well. These dilemmas stem from direct jurisdictional conflicts with domestic tribunals as well as the governing law provisions of the investment agreement claim that allow international law to be applied to aspects of the contract claim. Also, without any precedent in public international law for contractual remedies as such, the provisions raise the specter of a new hybrid-variety of contractual remedies grounded neither in public international law nor in domestic contract law. Such uncertainties could ultimately undermine the predictability and stability that are the goals of the U.S. Model BIT.

Before discussing the text of the investment agreement provisions of the DRC, I place the investment agreement provisions in their legal and historical context with an overview of the dispute resolution of transnational concession contracts. The investment agreement provisions are a compromise proposal in a historical debate on the internationalization of concession contracts and a response to more recent objections to the arbitration of concession contracts in investment tribunals. In Section 2, I sketch briefly the well-documented twentieth century evolution of various theories internationalization<sup>17</sup> of concession contracts advocated by capital-exporting countries and opposing doctrines favored by capital-importing countries. Then, after reviewing some general public international law principles regarding contracts between States and alien investors and the legal framework for investment treaty arbitration, in Section 3 I review the holdings of recent influential BIT arbitrations on the treatment of contract claims in treaty tribunals. Section 4 presents the key provisions of the DRC relating to investment agreements. In this Section I highlight how the investment agreement provisions of the DRC leave unresolved several of the objections to treaty arbitration

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regulatory takings doctrine and despite significant variation across contracts, stabilization clauses tend to significantly lower the threshold beyond which host states must pay compensation.”).

<sup>17</sup> SORNARAJAH, *supra* note 2.

of contract claims discussed in the investment treaty awards in Section 3. Finally, in Section 5, I explore in more detail the scope and implications of the conflict between the investment agreement provisions and the exercise of police powers by host States. I propose a narrower interpretation of the DRC in line with the customary international law of state contracts and investment treaty arbitration practice that is consistent with the international law prerogative of states to regulate for the public welfare. Section 6 concludes.

## 2. THEORIES ON THE INTERNATIONALIZATION OF STATE CONTRACTS

It is common for foreign investors who undertake a foreign investment project to bargain for an agreement with the host government granting rights or promising some measure of support for the carrying-out of the project. Even though in some investment situations, host State promises may only negligibly influence a foreigner's decision to invest, more acute situations arise in long-term, capital intensive projects where public services are provided or natural resources extracted in close cooperation with the host State. It is then impossible to discount the significance of promises made in such contracts for an investor's decision to pledge resources. At the same time, a breach of an agreement upon which such a long-term investment is based can result in significant losses for sunken costs that may not be fully recoverable against a host State in the host State's court system. There is also the problem of the obsolescing bargain:<sup>18</sup> the bargaining power of the investor is at its apex just before the conclusion of the agreement while the host State is seeking to induce capital, technology and know-how; afterwards the host State has incentives to unilaterally revise its terms.

Nevertheless, when a host government entity enters into a contract with an investor, the investor may be required to raise his or her grievance in the tribunals of the host State if a conflict arises, either because domestic law requires it or because the host State

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<sup>18</sup> Raymond Vernon, *International Investment and International Trade in the Product Cycle*, 80 Q.J. ECON. 190 (1966) (using tools such as the timing of innovation, the effects of scale economies, and the roles of ignorance and uncertainty to analyze the shifts in international trade and international investment).



had superior bargaining power in the negotiations. From the investor's point of view, this means the investor may face potentially biased host government institutions in the investment process, which may at various stages depend critically on the administrative decisions of the host State and/or be significantly affected by legislative changes in the legal framework of the investment. When an irreconcilable dispute over such a project arises, should an investor be able to bring a claim for breach of contract against a government in a public international forum such as a treaty tribunal?

The problem of how to protect foreign investments within a host country's legal system has been an ongoing concern for capital exporting countries since a series of nationalizations of petroleum concessions in the Middle East in the middle of the last century. Dissatisfied with the compensation from national tribunals for those expropriations and simultaneously faced with the collapse of the legal and political controls supporting traditional concession agreements after the Second World War, capital-exporting countries advanced various legal theories to afford concession contracts external legal protection outside of the host State legal system, that is, to "internationalize" them.<sup>19</sup> Accordingly, since the 1950s legal practitioners and academics from the capital-exporting countries have developed and propounded an alternative body of transnational contract law to apply to concession agreements that displaces or supplements national law, drawing inspiration, in many cases, from previously failed attempts to bring contract claims before the ICJ and other international tribunals. These theories surfaced in the *ad hoc* arbitrations following the petroleum nationalizations,<sup>20</sup> in which arbitrators grappled with the

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<sup>19</sup> See A.F.M. Maniruzzaman, *State Contracts in Contemporary International Law: Monist versus Dualist Controversies*, 12 EUR. J. INT'L L. 309, 309 (2001) (defining internationalization as a theory that "suggests that, no matter what law the parties to such a contract choose as the proper law of the contract, international law superimposes their choice and applies automatically as the overriding governing law").

<sup>20</sup> See *Sapphire Int. Petroleum Ltd. v. Nat'l Iranian Oil Co. (Sapphire)*, 35 I.L.R. 136 (Arb. Trib. 1963) (documenting a case that occurred in the 1960s as a result of the second oil nationalization in Iran). See also *British Petroleum Exploration Co. v. Libyan Arab Republic (BP v. Libya)*, 53 I.L.R. 297 (Arb. Trib. 1973); *Texaco Overseas Petroleum Corp. v. Libyan Arab Republic (TOPCO)*, 53 I.L.R. 389 (Arb. Trib. 1977); *Libyan Am. Oil Co. v. Libyan Arab Republic (LIAMCO)*, 20 I.L.M. 1 (Arb. Trib. 1981) (documenting the cases that the Libyan

interpretation and legal nature of a generation of petroleum concession agreements.

Internationalization was seen as all the more urgent by capital exporting companies as a developing country consensus had coalesced in the UN to recognize sovereign rights over the disposition of natural resources and a sovereign right to autonomous economic development. Over time, this competing norm of permanent sovereign rights over natural resources<sup>21</sup> was assimilated into the investment laws and constitutions of several developing countries. The strengthening of host State autonomy and supervision over concession contracts led capital exporting States to turn increasingly to investment treaties to secure protection for concession contracts, a trend which accelerated in the 1990s amid the fervor worldwide for liberalization of investment and trade and transparency in governance.<sup>22</sup>

### 2.1. *Choice of Law Clauses and Forum Selection Clauses*

Many advocates of the concept of internationalization have contended that by designating international law in the place of the domestic contract law as the governing law of the concession contract, and by choosing international arbitration in the forum selection clause, the host State will be bound under international law to the individual obligations in the agreement.<sup>23</sup> The most

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oil industry nationalization in 1970 gave rise to); *Kuwait v. Am. Indep. Oil Co. (AMINOIL)*, 21 I.L.M. 976 (Arb. Trib. 1982) (describing the ad hoc proceedings on compensation for nationalization that occurred in response to Kuwait's termination of a 1948 oil concession in favor of an American company); *Saudi Arabia v. Arabian Am. Oil Co. (ARAMCO)*, 27 I.L.R. 117 (Arb. Trib. 1963) (involving another arbitration concerning breach of a concession agreement).

<sup>21</sup> See G.A. Res. 626 (VII), U.N. Doc. A/2361 (Dec. 21, 1952), available at <http://www.un.org/documents/ga/res/7/ares7.htm> (detailing the "right to exploit freely natural wealth and resources"); G.A. Res. 1803 (XVII), U.N. Doc. A/5217 (Dec. 14, 1962), available at <http://www.un.org/documents/ga/res/17/ares17.htm> (describing states' permanent sovereignty over natural resources).

<sup>22</sup> See U.N. CONF. ON TRADE & DEV. [UNCTAD], *State Contracts*, at 6, U.N. Doc. UNCTAD/ITE/IIT/2004/11, U.N. Sales No. E.05.II.D.5 (2005) ("State contracts and the conflict of doctrines associated with them may be seen as a core purpose of making investment treaties.").

<sup>23</sup> See Robert Y. Jennings, *State Contracts in International Law*, 37 BRIT. Y.B. INT'L L. 156, 156 (1961) (examining "[h]ow far a sovereign State which enters into a contract with an alien becomes subject thereby to obligations of public international law").

common version of this theory assumes the existence of a kind of universal private international law of contract outside of either municipal law or public international law based on international commercial practice, a modern *lex mercatoria*, that applies to transnational concession contracts between alien investors and States. Proponents of this transnational law of State contracts have stressed the binding effects of selected general principles of law as referred to in Art. 38 of the Statute of the ICJ. In particular, they have relied heavily on *pacta sunt servanda*,<sup>24</sup> as well as the requirement to observe good faith<sup>25</sup> in contractual relationships and the doctrine of acquired rights.<sup>26</sup> Although the concept of a universal private law based on international commercial practices has found almost universal acceptance in international sales and finance contracting between private parties and, to a lesser extent, in procurement contexts, the same has not been true for concession contracts. Under concession contracts, the host State has traditionally enjoyed the rights of unilateral termination and modification and has encountered a standard of compensation for breach less than that for commercial contracts as a form of administrative contract.<sup>27</sup>

An alternative justification for the belief that choice of law and arbitration clauses could achieve internationalization is a theory characterizing modern concession contracts as public international law agreements.<sup>28</sup> A minority of scholars argues that, by virtue of

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<sup>24</sup> See *Sapphire*, 35 I.L.R. at 181 (involving the principle that every treaty in force is binding upon the parties to it and must be performed by them in good faith; thereby implying that a party cannot invoke provisions of its municipal law as justification for a failure to perform).

<sup>25</sup> See *Amco Asia Corp. v. Republic of Indon.*, 23 I.L.M. 351 (1983). See generally Int'l Inst. for the Unification of Private Law [UNIDROIT], art. 1.7 (1994), available at <http://www.unidroit.org/english/principles/contracts/main.htm> (codifying the good faith principle).

<sup>26</sup> See *Saudi Arabia v. Arabian American Oil Co.*, 27 I.L.R. 117, 117 (Arb. Trib. 1958).

<sup>27</sup> See Abul F.M. Maniruzzaman, *The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration?*, 14 AM. U. INT'L L. REV. 657 (1999) (discussing the principle of *lex mercatoria* which refers to rules devised by the business community to regulate commercial activities, including the general principle of laws as well as codified principles, such as the UNIDROIT principles).

<sup>28</sup> See Prosper Weil, *Problemes Relatifs aux Contrats Passés entre un Etat et un Particulier* [Problems Concerning Contracts Between States and Private Parties], 128

the unique character of agreements for the extraction of natural resources under EDAs or “economic development agreements” or “investment agreements,”<sup>29</sup> a breach of such an agreement would invoke State responsibility *per se*. In the TOPCO arbitration, the sole arbitrator Dupuy followed this theory<sup>30</sup> to conclude that a breach of an oil concession contract was internationally wrongful,<sup>31</sup> even though the governing law clause of the concession agreement at issue gave priority to domestic law. This theory met the frequent objection that it would confer treaty status onto concession agreements and elevate the investor party to the contract to the status of a sovereign in international law.

## 2.2 Umbrella Clauses

As an alternative to contractual devices, capital-exporting countries sought to protect concession contracts through bilateral treaties. The original vehicle for this was the “umbrella” or “obligations clause” which became a consistent feature of the new “investment protection treaties” introduced by Germany after WWII and later adapted by the UK and the U.S.<sup>32</sup> to replace its

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RECUEIL DES COURS 95 (1969) (claiming that treaties may elevate contractual undertakings into international law obligations by stipulating that breach by one State of a contract with a private party from the other State will also constitute a breach of the treaty between the two States).

<sup>29</sup> See Stephem M. Schwebel, *International Protection of Contractual Arrangements*, PROC. AM. SOC. INT'L L. 226, 269 (1959); Oyunchimeg Bordukh, *Choice of Law in State Contracts in Economic Development Sector—Is There Party Autonomy?* (2008) (unpublished S.J.D. thesis, Bond University) (on file with Bond University) (stating that EDAs “are not just a mere type of state contract made between a state or a state entity and a foreign national or a legal person of foreign nationality, rather [they] must satisfy certain criteria to be accepted as [a] foreign investment contract enforceable under international law”).

<sup>30</sup> See *Texaco Overseas Petroleum Corp. v. Libya*, Merits, 17 I.L.M. 1, para. 45 (1977) (holding that the Libyan government breached an “internationalized” foreign investment contract).

<sup>31</sup> See also *Anglo-Iranian Oil Co. (U.K. v. Iran)*, 1952 I.C.J. 93 (July 22) (involving a case wherein the British Government asserted this theory, but the Court declined jurisdiction); Memorial, 1952 I.C.J. 64, 74 (Feb. 4), *available at* <http://www.icj-cij.org/docket/files/16/8981.pdf> (discussing the double character of the Concession Convention of 1933).

<sup>32</sup> See Treaty Concerning the Treatment and Protection of Investments, U.S.-Pan., Oct. 27, 1982, 21 I.L.M. 1227; Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arm., Sept. 23, 1992, 1996 S. Treaty Doc. No. 103-11 (1993) (including umbrella clauses that were used in

Treaties of Friendship, Commerce and Navigation. Reproduced in various forms, umbrella clauses proliferated to such a degree that UNCITRAL has estimated that over forty percent of the more than 2500 BITs in existence contain umbrella clauses.<sup>33</sup> The first umbrella clause appeared in the 1957 Abs-Shawcross Draft Convention on Foreign Investment,<sup>34</sup> an early attempt to create a permanent international investment protection tribunal through a multilateral investment treaty. That clause, Article II, reads: "Each Party shall at all times ensure the observance of any undertakings which it may have given in relation to investments made by nationals of any other party."<sup>35</sup>

The idea for umbrella clauses derived from a 1954 draft settlement agreement for the Anglo-Iranian Oil Company's claims regarding Iran's oil nationalization program.<sup>36</sup> The settlement had created an "umbrella treaty" between Iran and the UK incorporating the private agreement between Iran and AIOC, such that a breach of the private agreement automatically became a breach of the treaty. Accordingly, under an expansive contemporary interpretation of umbrella clauses in treaty arbitration, an umbrella clause in an investment treaty elevates a contract breach by a State to an international wrongdoing, regardless of the nature of the contract or the specific provision breached, and as a consequence, vests the treaty tribunal with subject matter jurisdiction for the contract claim.<sup>37</sup> One investment

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negotiating treaties until NAFTA dropped the clause in 1994, along with any reference to contract claims).

<sup>33</sup> See Katia Yannaca-Small, *Interpretation of the Umbrella Clause in Investment Agreements*, (OECD Working Paper No. 3, 2006) (discussing examples of umbrella clauses, as well as the interpretation of umbrella clauses in investment agreements).

<sup>34</sup> See Draft Convention on Investments Abroad (Abs/Shawcross), Apr. 1959, reprinted in 5 INTERNATIONAL INVESTMENT INSTRUMENTS: A COMPENDIUM, 301 U.N. Doc. UNCTAD DITE/2 (2000).

<sup>35</sup> *Id.* art. 2.

<sup>36</sup> See Anthony C. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 ARB. INT'L 411, 413-18 (2004) (describing the history and function of the umbrella clause). See also Wong, *supra* note 1, at 137 (discussing the debates over the proper construction of the umbrella clause).

<sup>37</sup> See Thomas W. Wälde, *The Umbrella (or Sanctity of Contract/Pacta sunt Servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases*, TRANSNAT'L DISP. MGMT., Oct. 2004, available at <http://www.transnational-dispute-management.com/samples/freearticles/tv1-4>

treaty tribunal went farther to state: "An umbrella clause is usually seen as transforming municipal law obligations into obligations directly cognizable in international law."<sup>38</sup>

Those who argue that umbrella clauses in investment treaties operate to attach State responsibility to a State contract breach<sup>39</sup> and those who argue internationalization could be achieved through a choice of law clause, tend to defend their positions on similar grounds. They contend it was equitable to preserve a remedy when the host State retroactively uses its legislative or administrative powers to avoid or modify its obligations under a contract or otherwise interferes with the investor's property rights in a manner that nevertheless accords with domestic law.<sup>40</sup> Even if a State's conduct does not rise to outright expropriation, it was desirable and equitable to protect the investor's legitimate-investment-backed expectations.<sup>41</sup> Although less relevant today to

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-article\_2.htm (commenting on the original intentions behind the umbrella clause).

<sup>38</sup> Noble Ventures v. Romania, ICSID Case No. ARB/01/11, para. 53 (Oct. 12, 2005), available at <http://ita.law.uvic.ca/documents/Noble.pdf>.

<sup>39</sup> F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 BRIT. Y.B. INT'L L. 241, 246 (1981):

[I]t protects the investor against any interference with his contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of whether or not such interference amounts to expropriation. The variation of the terms of a contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for instance, by non-payment, the dissolution of the local company with which the investor may have contracted and the transfer of its assets (with or without the liabilities) – these and similar acts the treaties render wrongful.

<sup>40</sup> This was a central concern in the Sapphire arbitration. *Sapphire Int. Petroleum Ltd. v. Nat'l Iranian Oil Co.*, 35 I.L.R. 136 (Int'l Arb. Trib. 1963). These arguments had previously been used to justify the positions of the Swiss and French governments in the Losinger Case and the Norwegian Loan cases respectively. *Losinger Case (Switz. v. Yugo.)*, 1936 P.C.I.J. (ser. C) No. 78 (June 27); *Norwegian Loans (Fr. v. Nor.)*, 1957 I.C.J. 9 (July 6). In many if not most contemporary legal systems, public contracts contain a termination at will clause in favor of the government party. See Derek W. Bowett, *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 59 BRIT. Y.B. INT'L L. 49, 56–58 (1988) in which he discusses "termination at convenience clauses" in the United States and the U.K.

<sup>41</sup> *Kuwait v. Am. Indep. Oil Co.*, Final Award, 21 I.L.M. 976 (Int'l Arb. Trib. 1982). The norm of preserving legitimate-investment-backed expectations for concession projects has since independently become most progressively developed under the prohibition of uncompensated indirect expropriation and the fair and equitable treatment minimum treatment standard in BIT

post-independence developing countries, it was also argued that making specific contractual obligations binding through international law was necessary in areas of potential political turmoil with weak or incomplete systems of law.

### *2.3. Stabilization Clauses in Investment Agreements*

A third theory by which State contracts could be internationalized was the use of a stabilization clause in the concession agreement. In most newly independent capital-importing countries, concession agreements in the oil sector underwent significant transformations in form after independence through renegotiation after nationalization, or by agreement in line with profound changes in the conditions in industry. Consistent with the new legal relations between capital exporting countries and their former colonies, these changes reflected the fundamental shift in power in the developing countries over mineral rights. Traditionally no more than licenses to conduct economic activities within a territory in return for the remission of royalties, the new oil concession agreements emerged as complex structures with the investor agreeing to provide technical assistance and training and major infrastructural inputs on a long-term basis in cooperation with the host State. Most commonly taking the form of product-sharing agreements in the oil industry,<sup>42</sup> the new natural resource concession was generally highly regulated domestically and supervised by the host State through a State company. A typical product sharing agreement in the oil industry allocates the risk to the investor for the exploration and discovery of the mineral. If successful, the host country and investor share ownership over the extracted mineral until the investor's cost of exploration is fully recovered.<sup>43</sup>

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jurisprudence. Dolzer and Schreuer assert that the investor's legitimate expectations are based on the host State's legal framework for investment at the time of investment plus any explicit assurances on which the investor relied. RUDOLF DOLZER & CHRISTOPHER SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 134 (2008).

<sup>42</sup> For examples of the many forms that contemporary petroleum concession agreements can take, see the website of the Independent Petroleum Association of America, <http://www.ipaa.org>. See also R. DOAK BISHOP ET AL., *FOREIGN INVESTMENT DISPUTES: CASES, MATERIALS AND COMMENTARY* 213–316 (2005).

<sup>43</sup> Although I emphasize petroleum concessions here as they historically have been an influential source of arbitral cases on concession agreements, accelerated investment in public service concessions such as water purification, telecommunications and electricity generation under BOT and BOO schemes took

The stabilization clause, an older contractual device countering State interference in concession agreements, was correspondingly revised for the new legal realities. Termed by some commentators as a special variant of choice-of-law clause,<sup>44</sup> stabilization clauses are employed by investors to prevent governments from changing the terms of a concession agreement by imposing various compensation conditions to any changes in the contract. Stabilization clauses in pre-war concessions<sup>45</sup> simply attempted to prevent nationalization by forbidding the termination of the concession by administrative or legislative decree. Once nationalization of natural resource industries was generally recognized as legal if undertaken for legitimate public purposes and subject to adequate compensation,<sup>46</sup> investors began to incorporate stabilization clauses in investment agreements to allocate the financial risk of less drastic legislative changes lowering the value of the long-term investment. In so doing, stabilization clauses began to encompass a progressively broader range of government conduct. Contemporary stabilization clauses often seek to lock-in negotiated tax benefits and the off-take price in a public service or natural resource concession by forbidding changes in host country legislation that alter the conditions of the investment without the consent of the investor.<sup>47</sup> They may range in scope from a "freezing clause," requiring the applicable law to be the domestic law at the time of the conclusion of the contract to the exclusion of all subsequent regulation, to an economic

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place in the late 20th century, especially with the increase in privatization projects in the post-Soviet States. DOLZER & SCHREUER, *supra* note 41, at 73.

<sup>44</sup> *Id.* at 75.

<sup>45</sup> See, for example, Article 17 of the 1948 Concession Agreement between Aminoil and the Shaikh of Kuwait as relayed in Martin Hunter & Anthony Sinclair, *Aminoil Revisited: Reflections on a Story of Changing Circumstances*, in INTERNATIONAL INVESTMENT LAW AND ARBITRATION LEADING CASES FROM ICSID, NAFTA BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW, *supra* note 1, at 347.

<sup>46</sup> The arbitrator in the TOPCO arbitration found nationalization to be a violation of the concession's stabilization clause. *Texaco v. Libya (TOPCO)*, Merits, 17 I.L.M. 1, 25-31 (Int'l Arb. Trib. 1978). The arbitrators in *BP Libya*, *Liamco-Libya*, and *Aminoil* did not find that stabilization clauses could not render nationalization illegal. See Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 301-04 (1982).

<sup>47</sup> Thomas W. Waelde & George N'di, *Stabilising International Investment Commitments: International Law Versus Contract Interpretation*, 1 CENTRE FOR ENERGY PETROLEUM & MINERAL L. & POL'Y 9 (2000), available at <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/article1-9.html>.



equilibrium clause, which requires compensation in case of a change in expected profits from a project.<sup>48</sup>

Today, such stabilization clauses potentially conflict directly with public contracting laws in many countries as well as national constitutions. According to one view, however, even if stabilization clauses are invalid under domestic law, within investment agreements they are capable of binding the State under international law to specific investment obligations,<sup>49</sup> particularly if a relevant investment treaty contains an umbrella clause, or the choice of law clause in an arbitration clause for the investment agreement specifies international law and the forum selection clause calls for international arbitration. Some argue that the breach of a stabilization clause becomes an international wrongdoing as a breach of a sovereign commitment to refrain from exercising sovereign powers.<sup>50</sup>

Throughout the twentieth century, the international settlement of concession disputes under dispute resolution clauses was formalized through an expansion of institutions and a growing acceptance of the theory of party autonomy in judicial systems requiring judicial acquiescence in forum selection clauses. International commercial arbitration continued to gain credibility and currency with the widespread ratification of the New York

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<sup>48</sup> For a discussion of the implications of stabilization clauses for the exercise of social and environmental regulation, see Cotula, *supra* note 16.

<sup>49</sup> This was argued by the British government in *Anglo-Iranian Oil Co.* (U.K. v. Iran), 1952 I.C.J. Pleadings 64, 86–93 (July 22). Sornarajah summarizes this theory as, “[t]he inclusion of the stabilization clause was seen as evidencing the intention of the State party not to subject it to its domestic law but to subject it to some external system which would ensure the validity of the stabilization clause and the contract which contains it.” SORNARAJAH, *supra* note 2, at 408. The current approach to the validity of stabilization clauses is to balance the limitations on sovereignty imposed by the clause with the reasonable expectations of the parties in light of all the relevant circumstances. See IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 554 (5th ed. 1998).

<sup>50</sup> *Saudi Arabia v. Arabian Am. Oil Co. (ARAMCO)*, 27 I.L.R. 117 (Int’l Arb. Trib. 1963); *Sapphire Int. Petroleum Ltd. v. Nat’l Iranian Oil Co.*, 53 I.L.R. 163 (1963); *TOPCO*, 17 I.L.M. at 17. See *El Paso Energy International Company v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/15 (Apr. 27, 2006); *Pan Am. Energy LLC & B.P. Argentina Exploration Co. v. Argentina*, Preliminary Objections (PAE), ICSID Case No. ARB/03/13 (July 27, 2006), available at <http://ita.law.uvic.ca/documents/PanAmericanBPJurisdiction-eng.pdf> (highlighting the separation of general international law and treaty law). For an overview of the holdings of major ad hoc petroleum arbitrations concerning stabilization clauses, see Margarita Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 DENV. J. INT’L L. & POL’Y 217, 223–26 (2002).

Convention, making it much easier to enforce foreign and commercial arbitral awards than foreign judgments.<sup>51</sup> The establishment of ICSID in 1965 was a watershed event that permitted parties in a dispute over a concession agreement to request ICSID arbitration by presenting an agreement to arbitrate at ICSID in writing. The law relating to transnational State contract dispute resolution was developed through *ad hoc* petroleum arbitrations, the arbitrations of private tribunals of the ICC, public mixed claims tribunals,<sup>52</sup> and in ICSID tribunals.<sup>53</sup>

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<sup>51</sup> In the United States, the implementing legislation of the New York Convention under the Federal Arbitration Act is 9 U.S.C. §§ 3-4 (2006) (stating that proceedings shall be stayed when an issue therein has been referred to arbitration), 9 U.S.C. § 206 (stating that a court may force arbitration to be held), and 9 U.S.C. § 208 (stating that this chapter should not be applied in such a manner as to conflict with the Convention).

<sup>52</sup> Concerning oil concessions in the Iran-U.S. Claims tribunals, see *Amoco Int'l Finance v. Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189 (1987) (holding that the shareholding interest in Kharg Chemical Company was lawfully expropriated by the Government of Iran and that the Government of Iran shall pay Amoco compensation for the expropriation); *Mobil Oil Inc. v. Iran*, 16 Iran-U.S. Cl. Trib. Rep. 3 (1987) (holding that Iran is liable to Mobil for losses which Mobil could have expected to recover pursuant to successful negotiation of an agreement settling all the issues relating to the termination of the Sale and Purchase Agreement); *Sedco Inc. v. National Iranian Oil Co.*, 9 Iran-U.S. Cl. Trib. Rep. 248 (1985) (holding that Sedco's shareholder interest in Sediran Drilling Company was expropriated by Iran); *Phillips Petroleum Inc. v. Iran* (Iran-U.S. Cl. Trib. 1989), reprinted in *International Decisions*, 85 AM. J. INT'L L. 184 (1991) (holding the Government of Iran liable for compensation for property taken during the Iranian Revolution). The early history of state contracts in mixed claim tribunals in the Americas is documented in Chittharanjan F. Amerasinghe, *State Breaches of Contracts with Aliens and International Law*, 58 AM. J. INT'L L. 881 (1964) (detailing when the breach by a state of a contract between an alien and the state constitutes a breach of international law).

<sup>53</sup> See *Klockner v. Cameroon*, Award, 2 ICSID (W. Bank) 9 (1994) (rejecting the requests that Cameroon make payment of the outstanding balance of a fertilizer factory and that Cameroon be compensated for losses it had incurred in the abandoned fertilizer project); *S. Pac. Props. Ltd. v. Egypt*, Decision on Jurisdiction, ICSID Case No. ARB/84/3, reprinted in 3 ICSID (W. Bank) 131 (1992) (granting jurisdiction to the Centre as there was no agreed upon dispute resolution mechanism); *Amco Asia Corp. v. Indonesia*, ICSID Case No. ARB/81/1, reprinted in 1 ICSID (W. Bank) 377 (1988) (holding that the tribunal had jurisdiction over the parties); *Vacuum Salt Prod. Ltd. v. Ghana*, ICSID Case No. ARB/92/1, reprinted in 4 ICSID (W. Bank) 320 (1998) (dismissing the request for arbitration due to a lack of jurisdiction); *Liberian E. Timber Corp. v. Liberia*, ICSID Case No. ARB/83/2, Award of March 31, 1986 and Rectification of June 17,

Beginning in the 1990s, investment treaties with consent clauses came to play a more prominent role. Following a sharp rise in the number of BITs with arbitration consent clauses, investors attempted to use direct recourse arbitration to unilaterally seize investment treaty tribunals for concession contract claims by invoking the umbrella clause and other general language in the subject matter jurisdiction clauses of investment protection treaties. Usually they did so notwithstanding a forum selection clause in the contract calling for resolution in the courts of the host State. Thus, a body of BIT arbitration cases addressing claims arising from concession contract disputes<sup>54</sup> joined the earlier decisions relied on by arbitral tribunals to analyze transnational State contract issues. But rather than deciding the disputes as transnational contract claims, as would occur in international commercial arbitration, investment treaty tribunals have instead almost uniformly accepted jurisdiction because of a breach in a relevant substantive treaty obligation between States. In particular, they have awarded relief to investors in concession contract disputes based on more diverse and subtle interpretations of the violations of the prohibition against uncompensated expropriation and the duty of fair and equitable treatment.<sup>55</sup>

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1986, 26 I.L.M. 647 (1987) (holding Liberia breached the contract and must pay damages).

<sup>54</sup> See Catriona Paterson, *Investor-to-State Dispute Settlement in Infrastructure Projects* (OECD, Working Papers on International Investment No. 2006/2, 2006) (studying twenty-eight arbitrations under BITs in telecommunications, transportation, water and sanitation and the energy sector).

<sup>55</sup> See *Consortium R.F.C.C. v. Morocco*, Award, ICSID Case No. ARB/00/6 (Dec. 22, 2003); *PSEG Global, Inc., v. Turkey*, Award, ICSID Case No. ARB/02/5 (Jan. 19, 2007) (holding that Turkey breached its Treaty obligation to accord the investor fair treatment and must pay damages); *Aguas Del Tunari v. Bolivia* (Aguas), Decision on Jurisdiction, ICSID Case No. ARB/02/3 (Oct. 21, 2005) (holding that there is not sufficient evidence to support an allegation of abuse of corporate form or fraud); *Duke Energy Electroquil Partners v. Ecuador* (Duke Energy), Award, ICSID Case No. ARB/04/19 (Aug. 18, 2008) (holding that Ecuador breached the Treaty and must pay damages); *Azurix Corp. v. Argentina* (Azurix), Award, ICSID Case No. ARB/01/12 (July 14, 2006) (holding that Azurix has shown that it has a *prima facie* case against Argentina for breaching the Treaty); *CMS Gas Transmission Co. v. Argentina* (CMS Award), Award, ICSID Case No. ARB/01/8 (May 12, 2005) (holding that Argentina breached the obligation in the Treaty to accord the investor fair and equitable treatment and must pay damages); *CME Czech Republic B.V. v. Czech Republic* (CME), Award, UNCITRAL (Mar. 14, 2003) (holding that the Czech Republic breached the Treaty

After discussing the general principles of international law related to contract claims and investment treaty arbitration, below I present the reasoning of some of these BIT arbitrations on the treatment of contract claims in treaty tribunals. The awards below are predominantly concerned with the threshold question of whether the investment treaty tribunal has jurisdiction for contract claims based on the scope of the consent to arbitrate in the relevant treaty.

These cases are significant because they reflect the many dilemmas faced by public international law tribunals when considering contract claims, particularly the treatment of forum selection clauses. More broadly, the rationales of these decisions on umbrella clauses frequently go to the heart of objections to the jurisdiction of treaty tribunals for contract claims.

### 3. CONTRACT CLAIMS IN BIT TRIBUNALS

#### 3.1. General Principles

##### 3.1.1. *Breach of a Contract with an Alien Investor and State Responsibility*

Under the customary international law on the treatment of aliens and their property, an ordinary breach of a contract with an alien will not give rise to State responsibility in the absence of some discriminatory or arbitrary conduct.<sup>56</sup> Customary international law concerning State contracts with aliens evolved in the legal context of the system of diplomatic protection, in which the investor's State alone asserted its interests vis-à-vis the host State of

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and must pay damages); *MTD Equity Sdn. Bhd v. Chile (MTD)*, Award, ICSID Case No. ARB/01/7 (May 25, 2004) (holding that Chile breached the Treaty and must pay damages); *Occidental Petroleum Corp. v. Ecuador (Occidental)*, Decision on Jurisdiction, ICISD Case No. ARB/06/11 (Sept. 9, 2008) (holding that the Tribunal has jurisdiction over the dispute involving the investment Treaty); *Metalclad Corp. v. Mexico (Metalclad)*, Award, ICSID Case No. ARB(AF)/97/1 (Aug. 30, 2000) (holding Metalclad was not treated fairly or equitably under NAFTA and that Mexico must pay damages); *Técnicas Medioambientales Tecmed, S.A. v. Mexico (Tecmed)*, Award, ICSID Case No. ARB (AF)/00/2 (May 29, 2003) (holding that Mexico has breached the Treaty and must pay damages).

<sup>56</sup> See BROWNLEE, *supra* note 49, at 551 (noting that actions are discriminatory if directed against persons of a particular nationality or race; they are arbitrary when they lack a normal public purpose).

investment.<sup>57</sup> Historically a breach of a contract with an alien alone was not seen by the United Kingdom and other major capital exporting countries as justifying diplomatic protection because of adverse political side effects.<sup>58</sup> Other conditions must obtain in order for such a breach to qualify as a breach of an obligation to a State or individual under international law.<sup>59</sup> Traditional opinion states that this holds true even if a contract contains a clause making international law applicable to the contract. This follows from the doctrinal view denying the existence of a universal private law of contract, expressed by the PCIJ in the Serbian Loans case,<sup>60</sup> as well as from the fact that one of the parties to the contract is not a proper subject of international law, and therefore the contract is not a treaty.<sup>61</sup>

Specifically, customary international law provides redress for expropriation (direct or indirect) in the case that a government substantially impairs the value of an investment through unilateral interference with a contract by legislative or administrative means and the investor is not properly compensated.<sup>62</sup> Otherwise, customary international law would also provide a remedy if the State acted in so arbitrary a manner as to commit a “denial of justice.”<sup>63</sup> In sum, if a host State incidentally breaches a contract

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<sup>57</sup> See *Mavrommatis Palestine Concession Case* (Greece v. Gr. Brit.), 1924 P.C.I.J. (ser. A) No. 2, at 12 (Aug. 30) (stating that by taking up the case of one of its subjects and resorting to diplomatic action on his behalf, a state is in reality asserting its own rights).

<sup>58</sup> See R.Y. Jennings, *State Contracts in International Law*, 37 BRIT. Y.B. INT’L L. 156, 157–60 (1961) (detailing the historical attitudes of countries towards intervention in contract claims).

<sup>59</sup> For a thorough analysis of the circumstances when the breach of a contract with an alien could simultaneously be a breach of the law of State Responsibility, see Amerasinghe, *supra* note 52.

<sup>60</sup> See *Serbian Loans Case*, 1929 P.C.I.J. (ser. A) at 31 (July 12) (“Any contract which is not a contract between States in their capacity as subjects of international law is based on municipal law of some country.”).

<sup>61</sup> See Derek W. Bowett, *Claims Between States and Private Entities: the Twilight Zone of International Law*, 35 CATH. U. L. REV. 929, 936 (1986) (“[T]he relevance of international law is theoretically undeniable in such a case, but its practical relevance is limited by the fact that international law contains no rules relevant to a breach of contract as such.”).

<sup>62</sup> See BROWNIE, *supra* note 49, at 553.

<sup>63</sup> See JAN PAULSSON, DENIAL OF JUSTICE IN INTERNATIONAL LAW (2005); RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS OF THE UNITED STATES § 712 (1987)

with an investor while exercising its police powers in a non-discriminatory way without depriving the investor of the use or value of the asset in whole or significant part and provides the investor with an opportunity to contest the claim either in its own court system with fair procedural protections or in another forum, the host State has not committed an international wrong.

### 3.1.2. *The Jurisdiction of BIT Tribunals*

States have further defined responsibility and remedies in respect of the activities of one State's investors in the territory of the other through BITs and the investment chapters of Free Trade Agreements. Under this special system, comprised of both public international law and private law elements, rights arising from the breach of a BIT's standards for treatment toward the investor or investments vest directly with the investor and not with the investor's State.<sup>64</sup> The State of the investor has no residual interest in the requested remedy, which is awarded entirely to the affected investor. The award generally has no binding effect except with respect to the individual cases and parties; awards are considered commercial arbitral awards for purposes of enforcement. This subsystem of international law,<sup>65</sup> created by BITs, is not confined to the customary international law on State responsibility in relation to a breach of contract.<sup>66</sup>

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A state is responsible under international law for injury resulting from. . . (2) a repudiation or breach by the state of a contract with a national of another state (a) where the repudiation or breach is (i) discriminatory; or (ii) motivated by non-commercial considerations and compensatory damages are not paid; or (b) where the foreign national is not given an adequate forum to determine his claim of breach or is not compensated for any breach determined to have occurred.

*Id.*

<sup>64</sup> See Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRIT. Y.B. INT'L L. 151, 185-89 (2003) (noting that investment treaties confer an independent legal interest in investors).

<sup>65</sup> See *id.* at 159 (explaining the "hybrid or *sui generis* nature of the legal relationship between the investor and the host State that arises out of the investment regime.").

<sup>66</sup> See James Crawford, *Treaty and Contract in Investment Arbitration*, The 22nd Freshfields Lecture on International Arbitration 3 (Nov. 29, 2007), available at <http://www.lcil.cam.ac.uk/Media/lectures/pdf/Freshfields%20Lecture%202007.pdf>.

The dispute resolution clauses of BITs confer standing on a national of a Party State who makes a covered investment in the territory of another Party State concerning an irreconcilable "investment dispute." When a dispute falls under the subject matter jurisdiction clause of an investment treaty dispute resolution section and any procedural conditions agreed to by the States have been satisfied, the investment treaty expresses an offer of consent on the part of the State party to engage in arbitration with the investor at the investor's election. In determining whether a dispute is within the scope of the treaty parties' consent to arbitrate, BIT Tribunals are indisputably bound by the law of the interpretation of treaties, especially Articles 31 and 32 of the Vienna Convention on the Law of Treaties ("The Vienna Convention").<sup>67</sup> However, it is often contended that the consent under a BIT is more than merely an element of a treaty: James Crawford, for instance, has characterized the consent clause as contract, rather than a treaty, governed by international law that springs into effect when the investor perfects the consent by requesting arbitration.<sup>68</sup>

3.1.3. *Disputes with Public Entities over than the National Government*

Many of the cases dealing with contract issues that have come before investment treaty tribunals originated as disputes over contracts concluded with a local government, an independent governmental authority closely associated with a national government or under its authority, or a government-invested entity. In these cases, investors have invoked the customary international law rule of attribution to maintain the claim against the host State in the treaty tribunals. If an entity is recognized as "an organ of the central government" by the law of the country, or if it is "empowered by the law of the State to exercise elements of governmental authority," and it is acting in that capacity, acts of

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<sup>67</sup> See Vienna Convention on the Law of Treaties art. 31, May 23, 1969, 8 I.L.M. 679, 1155 U.N.T.S. 331 ("A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose."). This treaty approach to interpretation of the consent to arbitrate reflects the reasoning of the majority of Tribunals. *But see id.* art. 32 (discussing supplementary means of interpretation).

<sup>68</sup> See Crawford, *supra* note 66, at 10-11 (describing a BIT as a treaty containing an offer to arbitrate).

that entity will be attributed to the State for purposes of determining State responsibility.<sup>69</sup> Thus, normally, the fact that the counterparty to the contract in dispute is with a local government or a government-owned company would not by itself automatically bar a treaty claim against a national government, despite the fact that it bars the contract claim against the national government.<sup>70</sup>

### 3.2. *Investment Treaty Arbitral Jurisprudence on Contract Claims*

#### 3.2.1. *Treaty Claims Versus Contract Claims: Vivendi*

The most influential case to date setting out the principal issues in the treatment of contract claims in BIT tribunals is the *Vivendi Annulment*.<sup>71</sup> In sharp contrast to the oil arbitrations of the earlier era that considered international law and domestic law flexibly in matters of contract, the Ad Hoc Committee in the *Vivendi Annulment* pointedly distinguished treaty and contract claims according to the source of rights invoked and insisted on their resolution according to their respective sources of law.

The original Vivendi dispute centered on a thirty-year Concession Contract for water treatment between a French Company CGE (later purchased by Vivendi), and the Argentine

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<sup>69</sup> See Report of the International Law Commission to the General Assembly, Draft Articles on the Responsibility of States for Internationally Wrongful Acts, art. 4, U.N. Doc. A/56/10 (2001), reprinted in [2001] 2 Y.B. INT'L L. 21 (declaring that "the conduct of any State organ shall be considered an act of that State under international law"); see also *id.* art. 5 (explaining that persons or entities that do not fall under the purview of Article 4 may still be considered State actors so long as they exercise certain elements of the governmental authority). But see *id.* art. 5, cmt. 3 (noting that absent any stipulations in a treaty, the mere fact that an entity was established or funded by a State is not enough for its actions to be attributable to a State).

<sup>70</sup> In order to make a contract claim in an ICSID dispute against a State sub-entity, in addition to satisfying the subject matter jurisdiction of the treaty, the contract claims must involve a State sub-entity that was stipulated in advance. See ICSID Convention, *supra* note 7, art. 25(3) ("Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.").

<sup>71</sup> See *Compañía de Aguas del Aconquija S.A. v. Argentina (Vivendi Annulment)*, Decision on Annulment, ICSID Case No. ARB/97/3 (July 3, 2002), reprinted in 19 ICSID REV.: FOREIGN INVESTMENT L.J. 89 (2004) (coming to separate conclusions with respect to treaty and contract claims according to their individual sources of law).



Province of Tucumán.<sup>72</sup> The application for arbitration by CGE claimed that certain acts and omissions of Argentina, including those actions by the provincial authorities that should be attributed to Argentina under international law, violated the expropriation clauses and fair and equitable treatment guarantees of the France Argentine BIT.<sup>73</sup> The dispute resolution provisions of the BIT itself expressly gave the investor the choice to bring a claim in domestic courts or in international arbitration. The Concession Contract's forum selection clause, Article 16.4, provided for the exclusive jurisdiction of the contentious administrative courts of Tucumán. Argentina objected to jurisdiction of the BIT Tribunal on the grounds *inter alia* that the only dispute presented by the Claimants related exclusively to the Concession Contract, to which it, itself, was not a party. It also argued the dispute resolution provision of the Concession Agreement required the dispute to be submitted to the courts of Argentina.<sup>74</sup>

The original Vivendi Tribunal decided to separate the allegations of the claimant into claims against the national authorities (the federal claims) and the provincial authorities (the Tucumán claims). With respect to the federal claims, the Tribunal found that Argentina had not breached the treaty since the specific allegations made by the Claimants concerned the acts of Tucumán, and Argentina was under no duty to prevent or enjoin the actions of Tucumán under the treaty. With respect to the local claims, the Tribunal stated that the facts of the case made it impossible for it to distinguish or separate violations of the BIT from breaches of the Concession Contract without interpreting the Contract. Therefore, it agreed with the Argentina's objection that because the allegations relating to the actions of the Tucumán authorities had been assigned by the forum selection clause of the Concession Contract to the administrative courts of Tucumán, the claimants

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<sup>72</sup> See *Compañía de Aguas del Aconquija S.A. & Compagnie Générale des Eaux v. Argentina (Vivendi I)*, Award, ICSID Case No. ARB/97/3, paras. 56–61 (Nov. 21, 2000), reprinted in 16 ICSID REV.: FOREIGN INVESTMENT L.J. 641 (2001) (detailing the positions taken by each party to the arbitration).

<sup>73</sup> See Agreement on the Reciprocal Promotion and Protection of Investments, Arg.-Fr., art. 5, July 3, 1991, 1728 U.N.T.S. 298, 300 (providing for the protection of the investments made by each contracting party against expropriation and calling for favorable treatment should losses be suffered under certain circumstances).

<sup>74</sup> See *Vivendi I*, paras. 40–55 (discussing whether or not the BIT Tribunal had jurisdiction over the dispute).

had a duty to first pursue their rights with respect to such claims in the contractually agreed-upon forum.<sup>75</sup>

In this case, however, the obligation to resort to the local courts is compelled by the express terms of Article 16.4 of the [Concession Contract] and the impossibility, on the facts of the instant case, of separating potential breaches of contract claims from BIT violations without interpreting and applying the Concession Contract, a task that the contract assigns expressly to the local courts.<sup>76</sup>

In its 2002 Decision on Annulment, although the Annulment Committee found no fault with the Vivendi Tribunal's determination of the federal claims, it held that the Tribunal had manifestly exceeded its powers by failing to consider the local claims on the merits, because these claims alleged breaches of the treaty the Tribunal had held to be in its competence.<sup>77</sup> Emphasizing the two autonomous systems of municipal and international law, the Committee found that the Tribunal had mistakenly referred the international claims to the local courts solely on the basis of municipal law considerations. In so doing, the Committee denied that a forum selection clause agreed to by the parties could preclude the jurisdiction of a treaty Tribunal when a breach of the treaty was claimed.

A State may breach a treaty without breaching a contract, and vice versa, and this is certainly true of these provisions of the BIT.

[W]hether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law—in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract, in other words, the law of Tucumán. . . .<sup>78</sup>

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<sup>75</sup> *Id.* para. 81 (declaring that Article 16.4 provides clear remedies to the Claimant and that any decision that requires an application of the Concession Contract must be sought in the courts of Tucumán).

<sup>76</sup> *Id.*

<sup>77</sup> See *Vivendi Annulment*, paras. 111-12 (noting that the Tribunal could have ruled on the facts concerning breaches of the BIT and yet failed to do so).

<sup>78</sup> *Id.* para. 96.

In the Committee's view, it is not open to an ICSID tribunal having jurisdiction under a BIT in respect of a claim based upon a substantive provision of that BIT, to dismiss the claim on the ground that it could or should have been dealt with by a national court. In such a case, the inquiry which the ICSID tribunal is required to undertake is one governed by the ICSID Convention, by the BIT and by applicable international law. Such an inquiry is neither in principle determined, nor precluded, by any issue of municipal law, including any municipal law agreement of the parties.<sup>79</sup>

A state cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of its conduct as internationally unlawful under a treaty.<sup>80</sup>

Referring to the Woodruff Case,<sup>81</sup> the Committee reiterated the view that the legal effect of a forum selection clause should depend on whether the fundamental nature of the dispute was contractual or treaty-based. "[W]here the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract."<sup>82</sup>

On the other hand, where "the fundamental basis of the claim" is a treaty laying down an independent standard by which the conduct of the parties is to be judged, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state or one of its subdivisions cannot operate as a bar to the application of the treaty standard.<sup>83</sup>

After the Vivendi Annulment, BIT Tribunals began to face squarely the issue of jurisdiction over independent contractual claims on a more frequent basis. Prospective contract claimants attempted to advance breach of contract claims that were not

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<sup>79</sup> *Id.* para. 102.

<sup>80</sup> *Id.* paras. 102-03.

<sup>81</sup> Woodruff Case (U.S. v. Venez.), 9 R. INT'L ARB. AWARDS 213 (U.S.-Venez. Cl. Comm'n) 1903.

<sup>82</sup> *Vivendi Annulment*, para. 98.

<sup>83</sup> *Id.* para. 101.

simultaneously treaty breaches by contending: 1) an umbrella clause operating to convert a breach of contract claim into a treaty claim vests the Tribunal with jurisdiction for the contract claim or, 2) a generally-worded dispute resolution clause referring to "investment disputes" should be interpreted to include contract claims.<sup>84</sup> A few cases have considered the question of whether a Most Favored Nation ("MFN") clause can entitle an investor to bring his or her contract claim to investment arbitration, because the host State offers such a benefit to another country's investors. In practice, only a few tribunals have held in favor of independent contract claims jurisdiction,<sup>85</sup> and to the extent that investment treaty tribunals have considered jurisdiction for disputes arising out of contract claims, they have imposed various qualifications. The overwhelming majority of cases have held that BIT Tribunals will not have jurisdiction over a contract claim between a State and an alien unless the government's conduct at the time of the contractual breach also breached a substantive obligation under the treaty.<sup>86</sup>

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<sup>84</sup> See Emmanuel Gaillard, *Treaty-Based Jurisdiction: Broad Dispute Resolution Clauses*, N.Y. L.J., Oct. 6, 2005, at 3 (noting that the Vivendi decision broadened the field of potential investment claims under BITs); see also John P. Gaffney & James L. Loftis, *The 'Effective Ordinary Meaning' of BITs and the Jurisdiction of Treaty-Based Tribunals to Hear Contract Claims*, 8 J. WORLD INV. & TRADE 5, 47-67 (2007) (summarizing recent case law on umbrella clauses and broad dispute resolution clauses).

<sup>85</sup> See *SGS Société Générale de Surveillance S.A. v. Philippines* (SGS *Philippines*), Objections to Jurisdiction, ICSID Case No. ARB/02/6, para. 157 (Jan. 29, 2004), reprinted in 8 ICSID (W. Bank) 518 (2005) ("[I]t is not enough for the claimant to assert the existence of a dispute as to fair treatment or expropriation"); see also *Eureko B.V. v. Poland*, Partial Award and Dissenting Opinion, para. 262 (Aug. 19, 2005), available at <http://ita.law.uvic.ca/documents/Eureko-PartialAwardandDissentingOpinion.pdf>; *Noble Ventures, Inc. v. Romania*, Award, ICSID Case No. ARB/01/11, para. 136 (Oct. 12, 2005), available at <http://ita.law.uvic.ca/documents/Noble.pdf> ("A breach of the [Share Purchase Agreement] is, as a matter of law, capable of constituting a breach, attributable to the Respondent, of the BIT . . ."). But see *Fedax N.V. v. Venezuela*, Award, ICSID Case No. ARB/96/3 (Mar. 9, 1998), reprinted in 5 ICSID (W. Bank) 200 (2002) (finding that Venezuela must repay the principle on promissory notes owed to Fedax on the basis of the obligations clause of the U.S.-Venezuela BIT).

<sup>86</sup> See, e.g., *Sempra Energy Int'l v. Argentina* (Sempra on Jurisdiction), Objections to Jurisdiction, ICSID Case No. ARB/02/16 (May 11, 2005) (ruling that the ICSID only offers narrow jurisdiction and that parties must meet its requirements); *Sempra Energy Int'l v. Argentina* (Sempra Award), Award, ICSID Case No. ARB/02/16 (Sept. 28, 2007) (separating license claims from the acclaim that Argentina violated the umbrella clause of the treaty at issue), *Pan Am. Energy LLC v. Argentina*, Preliminary Objections (PAE), ICSID Case No.

### 3.2.2. *Jurisdiction for Independent Contractual Claims under Umbrella Clauses*

At least twenty cases in treaty arbitration have dealt with the issue of whether an umbrella clause internationalizes a State contract claim. The first of these, *SGS Pakistan*, sets out a restrictive interpretation of umbrella clauses, condemning the interpretation that they confer contract claims jurisdiction on a treaty tribunal except in extraordinary circumstances.

#### 3.2.2.1. *The Restrictive View: SGS Pakistan*

In 1994 the Claimant SGS entered into an agreement to provide pre-shipment inspection services for imports to Pakistan and estimates of customs revenues generated by the source country (the “PSI Agreement”). Although it prescribed a five-year contract period, the PSI Agreement allowed the parties to terminate at any time after the first year as long as three months notice was given. Its dispute resolution clause (Article 11.1) called for resolution in accordance with the Pakistan Arbitration Act with the seat of arbitration in Pakistan.<sup>87</sup>

The PSI entered into force on January 1, 1995, and the Pakistani government gave notice of termination in January 1997. During

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ARB/03/13, (July 27, 2006) (highlighting the separation of general international law and treaty law), *Impregilo S.p.A. v. Pakistan (Impregilo)*, Decision on Jurisdiction, ICSID Case No. ARB/03/3 (Apr. 22, 2005) (discussing jurisdiction over a breach of Italy–Pakistan BIT); *IBM World Trade Corp. v. Ecuador*, Decision on Jurisdiction, ICSID Case No. ARB/02/10 (Dec. 22, 2003), *reprinted in* 13 ICSID (W. Bank) 102 (2008) (ruling that the breach of the BIT was a separate issue legally and jurisdictionally than a breach of a concession contract); *AES Corp. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/02/17, para. 94 (Apr. 26, 2005), *available at* [http://ita.law.uvic.ca/documents/AES-Argentina-Jurisdiction\\_001.pdf](http://ita.law.uvic.ca/documents/AES-Argentina-Jurisdiction_001.pdf) (stating that the ICSID Tribunal “has no jurisdiction over any breach of the concession contracts binding upon the companies controlled by AES and the Argentine public authorities under administrative Argentine law, unless such breach would at the same time result in a violation by the host State of its obligations towards the U.S. private investors under the BIT”); *Joy Mining Mach., Ltd. v. Egypt (Joy Mining)*, Award on Jurisdiction, ICSID Case No. ARB/03/11, para. 30 (Aug. 6, 2004), *reprinted in* 13 ICSID (W. Bank) 121 (2008) (calling for a careful review of all claims when “the parties have such divergent views about the meaning of the dispute in light of the Contract and the Treaty.”).

<sup>87</sup> *SGS Société Générale de Surveillance S.A. v. Pakistan (SGS Pakistan)*, Decision of the Tribunal on Objections to Jurisdiction, ICSID Case No. ARB/01/13, paras. 11–15 (Aug. 6, 2003), *available at* [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC657\\_En&caseId=C6](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC657_En&caseId=C6) (describing the history and the terms of the agreement between SGS and Pakistan).

the intervening period services were performed and invoices were paid partially by Pakistan. SGS filed a commercial claim in Swiss courts for “wrongful termination of contract” that was dismissed for reasons of sovereign immunity. In September 2000, Pakistan invoked Article 11.1 of the PSI Agreement by asking the Supreme Court of Pakistan to refer the decision to an arbitrator in accordance with the Pakistan Arbitration Act, to which SGS responded with counterclaims of “wrongful repudiation of contract.”<sup>88</sup>

While these claims were pending, SGS initiated ICSID arbitration against the government of Pakistan for violation of five articles of the Swiss Pakistani BIT,<sup>89</sup> including: failure to promote SGS’s investment (Article 3(1)), failure to protect SGS’s investment (Article 4(1)), failure to ensure the fair and equitable treatment of SGS’s investment (Article 4(2)), and expropriation without compensation (Article 6(1)).<sup>90</sup> SGS simultaneously asked the Tribunal to find liability for breach of the PSI contract under an “observance of commitments” clause, Article 11. SGS then unsuccessfully made several attempts to stay the Pakistan arbitration through local courts pending the outcome of ICSID arbitration. Eventually the ICSID Tribunal recommended a stay of the Pakistan arbitration until it had made a determination on its jurisdiction, to which the Pakistani arbitrator agreed.

As recalled in the Decision on Jurisdiction of August 2003, Pakistan’s central argument was that jurisdiction should be denied because the claims were entirely contractual in nature,<sup>91</sup> the treaty claims comprising merely a relabeling of the previously submitted contract claim. Citing the Vivendi Annulment, Pakistan argued because the PSI agreement contained a valid forum selection clause for the contract, it should be respected by the Tribunal. The jurisdiction of the ICSID Tribunal is “limited to the adjudication of disputes that the parties have actually agreed to submit to the

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<sup>88</sup> *Id.* paras. 16, 20–29.

<sup>89</sup> Agreement on the Promotion and Reciprocal Protection of Investments, Switz.-Pak., July 11, 1995, available at <http://www.admin.ch/ch/f/as/1998/2601.pdf> [hereinafter Swiss Pakistan BIT].

<sup>90</sup> *SGS Pakistan*, ICSID Case No. ARB/01/13. The complaint set out 8 heads of compensation, including payment of outstanding invoices of U.S. \$8,368,430.49, compensation for lost profits of U.S. \$31,500,000 and compensation for “lost opportunities” of U.S. \$70,000,000 which were substantially the same as those in the Pakistan arbitration.

<sup>91</sup> *Id.* paras. 43–44.

Centre and not to an alternative forum” under the principles of *pacta sunt servanda* and party autonomy.<sup>92</sup> In the alternative, if BIT claims existed that were not identical to the contract claims, the PSI arbitration clause was broad enough to encompass them, therefore all claims should be submitted to the Pakistani arbitration.<sup>93</sup>

#### 3.2.2.1.1. Holding on Contract Claims

Addressing the issue of whether it could adjudicate solely contract claims, the Tribunal’s decision began with an analysis of the validity and priority of the PSI Agreement arbitration clause. “Article 11.1 of the PSI Agreement is a valid forum selection clause *so far as concerns the Claimant’s contract claims which do not also amount to BIT claims*, and it is a clause that this Tribunal should respect.”<sup>94</sup> It further denied that the wide dispute resolution clause of the BIT, Article 9, referring to “disputes with respect to investments” included contract claims. “That phrase, however, while descriptive of the *factual subject matter* of the disputes, does not relate to the *legal basis* of the claims, or the *cause of action* asserted in the claims.”<sup>95</sup>

Accordingly, the Tribunal held that it had no jurisdiction with respect to claims based on alleged breaches of the PSI Agreement that did not also constitute or amount to breaches of the substantive standards of the BIT.<sup>96</sup>

#### 3.2.2.1.2. Holding on the umbrella clause

Article 11 of the Swiss Pakistan BIT reads: “Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party.”<sup>97</sup>

In its textual analysis the Tribunal could not find specific intent by the treaty Parties to “elevate” contract breaches to treaty claims.

Considering the widely accepted principle with which we started, namely, that under general international law, a

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<sup>92</sup> *Id.* paras. 48–50.

<sup>93</sup> *Id.* para. 70.

<sup>94</sup> *Id.* para. 161 (emphasis in original).

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* para. 162.

<sup>97</sup> *Id.* para. 163 (quoting Swiss Pakistan BIT).

violation of a contract entered into by a State with an investor of another State, is not, by itself, a violation of international law, and considering further that the legal consequences that the Claimant would have us attribute to Article 11 of the BIT are so far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party, we believe that clear and convincing evidence must be adduced by the Claimant [of shared intent of such interpretation]. . . . We do not find such evidence in the text itself of Article 11.<sup>98</sup>

Specifically, among other consequences, if Article 11 internationalized every contract claim, "there would be no real need to demonstrate a violation of those substantive treaty standards if a simple breach of contract, or of municipal statute or regulation, by itself, would suffice to constitute a treaty violation. . . ."<sup>99</sup>

The Tribunal considered that the umbrella clause could be nothing more than "an implied affirmative commitment to enact implementing rules and regulations necessary or appropriate to give effect to a contractual or statutory undertaking in favor of investors of another Contracting Party that would otherwise be a dead letter."<sup>100</sup> The Tribunal could not find that

Article 11 of the BIT had the effect of entitling a Contracting Party's investor, like SGS, in the face of a valid forum selection contract clause, to 'elevate' its contract claims with another Contracting Party, like the PSI Agreement, to claims grounded in a BIT, and accordingly to bring such contract claims to this Tribunal for resolution and decision.<sup>101</sup>

#### 3.2.2.2. *The Expansive View: SGS Philippines*

Six months after the SGS Pakistan proceeding, a Tribunal adjudicated a dispute over a similar type of contract by an

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<sup>98</sup> *Id.* para. 167.

<sup>99</sup> *Id.* para. 168.

<sup>100</sup> *Id.* para. 172.

<sup>101</sup> *Id.* para. 165.



affiliated company under the Swiss-Philippines BIT.<sup>102</sup> Based on a differently-worded clause, its reasoning came to the exactly opposite conclusion on jurisdiction over purely contractual claims and the legal effect of umbrella clauses. However, its initial holding led to a similar outcome by deferring to local courts for a consideration of the amount due under the contract claim.

In 1991 the Republic of Philippines entered into a contract with SGS for Comprehensive Import Supervision Service ("CISS") to verify the quality, quantity and price of imported goods prior to shipment to the Philippines for an initial period of three years. Article 12 of the CISS Agreement read: "The provisions of this Agreement shall be governed in all respects by and construed in accordance with the laws of the Philippines. All actions concerning disputes in connection with the obligations of either party to this Agreement shall be filed at the Regional Trial Courts of Makati or Manila."<sup>103</sup> The contract was extended twice with amended services but was not renewed after the second extension concluded in 2000. During the contract period, enormous volumes of commerce were inspected and invoiced at U.S. \$680 million but a government inquiry found that only about U.S. \$540 million was paid.

SGS commenced ICSID arbitration based on breaches of clauses of the Swiss-Philippines BIT guaranteeing full protection and security (Article IV(1)); fair and equitable treatment (Article IV (2)); effective and adequate compensation in cases of expropriation (Article VI(1)); and observation of obligations (Article X (2)) (the umbrella clause).<sup>104</sup>

Among its objections to jurisdiction, the Philippines argued that as the dispute's essential basis was contractual, the Tribunal's jurisdiction was precluded by a previous dispute resolution agreement in the CISS Agreement.<sup>105</sup> "Article 12 represents a real and genuine agreement, being the product of an arms-length bargain of the parties which . . . resulted from a competitive tender and bidding process."<sup>106</sup> It further maintained that the Swiss-

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<sup>102</sup> See *SGS Société Générale de Surveillance S.A. v. Philippines*, Decision Jurisdiction (SGS Philippines), ICSID Case No. ARB/02/6, para. 157 (Jan. 29, 2004), reprinted in 8 ICSID (W. Bank) 518 (2005).

<sup>103</sup> *Id.* para. 22.

<sup>104</sup> *Id.* para. 44.

<sup>105</sup> *Id.* para. 51.

<sup>106</sup> *Id.* para. 52.

Philippines BIT had no application to purely contractual disputes and denied the BIT was intended to override previous obligations with respect to "specific investments."<sup>107</sup>

With respect to the umbrella clause, the Philippines response in part echoed the SGS Pakistan Tribunal's reasoning:

SGS's interpretation of Article X(2) effectively emasculates the substantive protection contained in Arts. III-VI. What SGS is effectively saying is that this substantial body of international law practice is now to be rendered effectively otiose because the Claimant need no longer prove the additional element, it need only argue that a breach of a private, commercial contract has been violated by a State and yet still be able to pursue its grievances in an international forum.<sup>108</sup>

### 3.2.2.2.1 Holding on the Umbrella Clause

The umbrella clause of the Swiss-Philippines BIT States: "Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party."<sup>109</sup> The Tribunal found that an analysis of the clause's mandatory wording, its order in the treaty text in the substantive section, and the declared object and purpose of the treaty supported the Claimant's interpretation.<sup>110</sup> But the Tribunal stressed that the umbrella clause did not convert questions of contract law into questions of treaty law, nor did it change the proper law of the CISS Agreement from the law of the Philippines to international law. Under Article X(2) the Philippines was internationally responsible for the performance of the obligations under the contract only once the terms had been ascertained under the terms of the contract.<sup>111</sup>

The basic obligation on the State in this case is to pay what is due under the contract, which is an obligation that is assumed with regard to the specific investment (the performance of services under the CISS Agreement). But this obligation does not mean that the determination of

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<sup>107</sup> *Id.* para. 51(e).

<sup>108</sup> *Id.* para. 76.

<sup>109</sup> *Id.* para. 115.

<sup>110</sup> *Id.* paras. 115-16.

<sup>111</sup> *Id.* para. 126.

how much money the Philippines is obliged to pay becomes a treaty matter. The extent of the obligation is still governed by the contract, and it can only be determined by reference to the terms of the contract.<sup>112</sup>

#### 3.2.2.2.2. Holding on Contract Claims

The tribunal held that the dispute resolution clause of the treaty referring to “disputes with respect to investments between a Contracting Party and an investor of the other Contracting Party”<sup>113</sup> was intended to include contract claims because among the *fora*, only the treaty Tribunal was competent to consider both treaty and contract claims. Therefore, efficiency counseled treating the claims in a single forum.<sup>114</sup> But the Tribunal made clear that the BIT could not override the effective and exclusive dispute resolution clause in the CISS agreement, nor did the BIT “give SGS an alternative route for the resolution of contractual claims which it was bound to submit to the Philippine courts under that Agreement.”<sup>115</sup> Instead, the Tribunal decided that the significance of the exclusive forum selection clause went to the question of admissibility:

Thus the question is not whether the Tribunal has jurisdiction: unless otherwise expressly provided, treaty jurisdiction is not abrogated by contract. The question is whether a party should be allowed to rely on a contract as the basis of its claim when the contract itself refers that claim exclusively to another forum. In the Tribunal’s view the answer is that it should not be allowed to do so, unless there are good reasons, such as *force majeure*, preventing the claimant from complying with its contract. This impediment, based as it is on the principle that a party to a contract cannot claim on that contract without itself complying with it, is more naturally considered as a matter of admissibility than jurisdiction. . . . SGS should not be

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<sup>112</sup> *Id.* para. 127.

<sup>113</sup> *Id.* para. 34.

<sup>114</sup> *Id.* para. 132.

<sup>115</sup> *Id.* para. 143.

able to approbate and reprobate in respect of the same contract . . . .<sup>116</sup>

Moreover, as the only issue effectively left to be decided was the amount of the claim, the Tribunal held that until the question of the scope of the Respondent's obligation to pay is clarified, either by agreement or submission to the Philippine court, that its decision would be premature and ordered a stay for both types of claims.<sup>117</sup>

### 3.2.2.2.3. SGS Philippines Revisited

With no resolution forthcoming after three-and-a-half years, the Tribunal in September 2007 informed the Parties that the stay would be lifted in order to allow them to hold a hearing to present their views on the State of the dispute and to decide whether the conditions of admissibility still obtain.<sup>118</sup> At the hearing the Tribunal ascertained that the amount due on the invoice had been satisfactorily determined by government accounting. It then considered two additional issues. First, the Claimant had abandoned the request for contractual interest for the amount of interest due on the unpaid invoice and instead requested the more favorable compounded interest rate under international law. Secondly, the Claimant alleged that due to fraudulent reporting of export clearances in China, an additional U.S. \$113 million in losses had been sustained.

As to the interest, the Tribunal decided:

Its claim to international law interest for non-payment of the amount due under Article X(2) of the BIT is predicated on the finding of a breach of that article, and as explained above, the conditions for the award of interest under international law (which are in the discretion of the Tribunal) have so far not been met.<sup>119</sup>

Concerning the "Chinese fraud" allegation, it stated:

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<sup>116</sup> *Id.* paras. 154–55.

<sup>117</sup> *Id.* para. 175.

<sup>118</sup> See *SGS Société Générale de Surveillance S.A. v. Philippines*, Order of the Tribunal on Further Proceedings, ICSID Case No. ARB/02/6, paras. 25, 27 (Dec. 17, 2007), available at <http://ita.law.uvic.ca/documents/SGSvPhil-order.pdf>.

<sup>119</sup> *Id.* para. 24.

... it cannot be said that there is in any forum a distinct dispute between the parties as to sums due by one to the other arising from the allegation. In these circumstances it is difficult to see how it could of itself preclude the admissibility of SGS's claim to payment under the BIT.<sup>120</sup>

Accordingly, because the Tribunal concluded that the conditions for inadmissibility no longer obtained, it ordered the parties to continue the treaty arbitration.<sup>121</sup>

The SGS Pakistan restrictive view of the legal effect of umbrella clauses has been endorsed by such tribunals as those in *Salini v. Jordan*,<sup>122</sup> *Joy Mining, Impregilio, El Paso*,<sup>123</sup> and *PAE*.<sup>124</sup> The tribunals in *Noble Ventures*, *Eureko Mining*, *MTD equity*, *LG & E*, *Siemens*, *Duke Energy*, and *Sempra*<sup>125</sup> took a more expansive view in line with *SGS Philippines*. Among these, only the tribunals in *Noble Ventures*<sup>126</sup> and *Eureko Mining*<sup>127</sup> accepted that a breach of a contractual obligation was identical to a treaty breach. Many have required a legislative or executive commitment in addition to those made in the contract itself to trigger the operation of the umbrella clause,<sup>128</sup> and some have applied the umbrella clause only to the breach of the legislative commitment itself and not to a specific

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<sup>120</sup> *Id.* para. 25.

<sup>121</sup> *Id.* para. 28.

<sup>122</sup> *Salini Costruttori S.p.A. v. Jordan*, Decision on Jurisdiction, ICSID Case No. ARB/02/13, paras. 120–30 (Nov. 9, 2004).

<sup>123</sup> *El Paso Energy Int'l Co. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/15, paras. 84–88 (Apr. 27, 2006), *reprinted in* 21 ICSID REV.: FOREIGN INVESTMENT L.J. 488 (2006).

<sup>124</sup> *Pan Am. Energy LLC v. Argentina*, Decision on Preliminary Objections (PAE), ICSID Case No. ARB/03/13, paras. 94–116 (July 27, 2006), *available at* <http://ita.law.uvic.ca/documents/PanAmericanBPJurisdiction-eng.pdf>.

<sup>125</sup> *Sempra Energy Int'l v. Argentina*, Award (Sempra Award), ICSID Case No. ARB/02/16, paras. 310–14 (Sept. 28, 2007), *available at* [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694\\_En&caseId=C8](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694_En&caseId=C8).

<sup>126</sup> *Noble Ventures, Inc. v. Romania*, Award, ICSID Case No. ARB/01/11, para. 136 (Oct. 12, 2005) *available at* <http://ita.law.uvic.ca/documents/Noble.pdf>.

<sup>127</sup> *Eureko B.V. v. Poland*, Partial Award and Dissenting Opinion, para. 262 (Aug. 19, 2005), *reprinted in* 12 ICSID (W. Bank) 335 (2005).

<sup>128</sup> *Duke Energy Electroquil Partners v. Ecuador*, Award, ICSID Case No. ARB/04/19, para. 322 (Aug. 18, 2008), *available at* <http://www.arbitration.fr/resources/ICSID-ARB-04-19.pdf>.

commitment in a contract.<sup>129</sup> One tribunal held that an umbrella clause breach occurred by a violation of a power purchase agreement because of assurances provided by the existing statutory framework for energy regulation.<sup>130</sup>

#### 3.2.2.2.4. The Test of Pussiance Publique: Impreglio

A few tribunals have justified the limitation on contract claims jurisdiction by reference to “the test of *puissance publique*.” Under this principle, only government conduct in a sovereign capacity can trigger the treaty’s protection through the umbrella clause, not a mere contractual breach. The Impreglio Tribunal, in considering whether the umbrella clause internationalized a contract for construction of a barrage and water channel, expressed this view:

Only the State in the exercise of its sovereign authority (*puissance publique*) and not as a contracting party, may breach the obligations assumed under the BIT. In other words, the investment protection treaty only provides a remedy to the investor where the investor proves that the alleged damages were a consequence of the Host State acting in breach of the obligations it had assumed under the treaty.<sup>131</sup>

#### 3.2.2.2.5. Joy Mining: Denying Protection for Commercial Claims

Several tribunals have criticized the adjudication of contract claims in treaty tribunals on the grounds that to allow it would be “destructive” of the two legal orders, municipal and international. The Joy Mining Tribunal considered a dispute arising out of a

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<sup>129</sup> *Sempra Award*, paras. 305–22 (Sept. 28, 2007).

<sup>130</sup> *LG&E v. Argentina*, Decision on Liability, ICSID Case No. ARB/02/1, para. 175 (Oct. 3, 2006), available at [http://ita.law.uvic.ca/documents/ARB021\\_LGE-Decision-on-Liability-en.pdf](http://ita.law.uvic.ca/documents/ARB021_LGE-Decision-on-Liability-en.pdf).

<sup>131</sup> *Impregilo S.p.A. v. Pakistan*, Decision on Jurisdiction (Impreglio), ICSID Case No. ARB/03/3, para. 260 (Apr. 22, 2005), available at <http://ita.law.uvic.ca/documents/impregilo-decision.pdf>. The “*puissance publique*” test to determine whether a contractual breach may be asserted as a breach of the BIT is discussed in *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Pakistan*, Decision on Jurisdiction, ICSID Case No. ARB/03/29, para. 180 (Nov. 14, 2005), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC523\\_En&caseId=C27#17](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC523_En&caseId=C27#17).

supply contract for longwall mining systems in a phosphate mine (“the Contract”) between Joy Mining Machinery Limited and the General Organization for Industrial and Mining Projects of the Arab Republic of Egypt (“IMC”).<sup>132</sup> The Contract and a later Amendment Agreement required letters of guarantee for contract performance and a timetable for release of these guarantees connected to the performance and the achievement of certain levels of phosphate production. The guarantee amounted to UK£ 9,605,228, about two-thirds of the total Contract price.<sup>133</sup> The Contract contained an arbitration clause requiring “all matters in dispute” to be settled under the rules of UNCITRAL through the regional center for arbitration in Cairo after obtaining the consent of the Ministry of Industry, or, through the Egyptian courts.<sup>134</sup> Disagreements arose and persisted as to the causes of performance problems. In the end, IMC paid the full purchase price of the equipment according to the Contract but declined to release the guarantees.

In bringing the dispute to ICSID, Joy Mining asserted that the Contract was an investment under the United Kingdom-Arab Republic of Egypt Agreement for the Promotion and Protection of Investments (“the Treaty”) and that the failure to release the guarantees was a violation of several provisions of the Treaty.<sup>135</sup> In particular it claimed that the equipment obtained by the letters of guarantee had been expropriated, that free transfer of funds had been prevented and that Egypt had failed to accord fair and equitable treatment and full protection and security to its investment.<sup>136</sup> In addition, Joy Mining asserted that by virtue of Article 2(2) of the Treaty, the umbrella clause, all violations of the Contract were violations of the Treaty.<sup>137</sup>

The tribunal did not accept the characterization of the Contract or the guarantees as investments for the purposes of the treaty. Instead it considered the contractual arrangements for the guarantees a “contingent liability.”<sup>138</sup> Neither did it think it would

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<sup>132</sup> Joy Mining Machinery, Ltd. v. Arab Republic of Egypt, Award on Jurisdiction, ICSID Case No. ARB/03/11, para. 15 (Aug. 6, 2004).

<sup>133</sup> *Id.* para. 17.

<sup>134</sup> *Id.* para. 92.

<sup>135</sup> *Id.* para. 22.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* para. 68.

<sup>138</sup> *Id.* para. 44.

be possible to expropriate "a contingent liability."<sup>139</sup> Thus, it found the entire dispute to be an ordinary commercial dispute. In the absence of treaty claims, the tribunal held that it had no jurisdiction. It reasoned:

The Tribunal is also mindful that if a distinction is not drawn between ordinary sales contracts, even if complex, and an investment, the result would be that any sales or procurement contract involving a State agency would qualify as an investment. International contracts are today a central feature of international trade . . . . Yet, those contracts are not investment contracts, except in exceptional circumstances, and are to be kept separate and distinct for the sake of a stable legal order.<sup>140</sup>

The tribunal further noted that "a basic general distinction can be made between commercial aspects of a dispute and other aspects involving the existence of some forms of State interference with the operation of the contract involved."<sup>141</sup>

The tribunal also stated:

Disputes about the release of bank guarantees are a common occurrence in many jurisdictions and the fact that a State agency might be a party to the Contract involving a commercial transaction of this kind does not change its nature. It is still a commercial and contractual dispute to be settled as agreed to in the Contract, including the resort to arbitration if and when available.<sup>142</sup>

Consequently the tribunal observed, concerning the umbrella clause:

In this context, it could not be held that an umbrella clause inserted in the Treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of the Treaty rights and obligations or a violation of contract rights of such a

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<sup>139</sup> *Id.* para. 78.

<sup>140</sup> *Id.* para. 58.

<sup>141</sup> *Id.* para. 72.

<sup>142</sup> *Id.* para. 79.



magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect. This might be perfectly different in other cases where that link is found to exist, but certainly it is not the case here.<sup>143</sup>

3.2.2.2.6. Protection for Investment Agreements: El Paso and PAE

A few tribunals have averred that entering into a contractual relationship with an investor could trigger the protection of the umbrella clause, depending on the nature of the contract. On the view that it is “necessary to distinguish the State as a merchant or as a sovereign,” the tribunals in *El Paso*, and its companion case *Pan American Energy*, drew particularly on the distinction between a contractual legal relationship between the State and the investor that arises due to the State acting in a commercial capacity (*jus imperii*) and a contractual legal relationship that arises due to the State acting in a sovereign capacity (*jus gestionis*).<sup>144</sup> Apparently on this basis the *El Paso* and the *PAE* Tribunals declared that all contracts constitute either commercial contracts or investment agreements.<sup>145</sup> Further, only investment agreement breaches could be converted to treaty breaches by the umbrella clause. In other words: “[those] contract claims stemming from an investment agreement *stricto sensu*, that is an agreement in which the State appears as a sovereign, and not all contracts signed with the State or one of its entities . . . .”<sup>146</sup>

Offering little other explicit support for this theory, the tribunal arrived at this conclusion in the particular case by interpreting the umbrella clause in Article II of the Argentine-U.S. BIT, in light of the dispute resolution clause, Article VII(1). The umbrella clause reads: “each Party shall observe any obligation it may have entered

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<sup>143</sup> *Id.* para. 81.

<sup>144</sup> *El Paso Energy Int’l Co. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/15, para. 79 (Apr. 27, 2006).

<sup>145</sup> *Id.* para. 77 (“Either the foreign investor has a commercial contract with an autonomous State entity or it has an investment agreement with the state, in which some ‘clauses exorbitantes du droit commun’ are inserted.”).

<sup>146</sup> *Id.* para. 80. See also *CMS Gas Transmission Co. v. Argentina*, Award, ICSID Case No. ARB/01/8, paras. 299–300 (May 12, 2005) (noting “that not all contract breaches result in breaches of the treaty”).

into with regard to investments.”<sup>147</sup> The dispute resolution clause of Article VII(1) states:

[A]n investment dispute is a dispute between a Party and national or company of the other Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorization . . . or, (c) an alleged breach of any right conferred and created by this Treaty with respect to an investment.<sup>148</sup>

Read in conjunction with the dispute resolution clause, the tribunal considered that the umbrella clause “will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign, such as a stabilization clause inserted into an investment agreement.”<sup>149</sup>

Furthermore:

[I]n the Tribunal’s view, it is especially clear that the umbrella clause does not extend to any contract claims when such claims do not rely on a violation of the standards of protection of the BIT . . . unless some requirements are respected. However, there is no doubt that if the State interferes with contractual rights by a unilateral act, whether these rights stem from a contract entered into by a foreign investor with a private party, a State autonomous entity or the State itself, in such a way that the State’s action can be analyzed as a violation of the standards of protection embodied in a BIT, the treaty-based arbitration tribunal has jurisdiction over all the claims of the foreign investor, including the claims arising from a violation of its contractual rights. Moreover, Article II, read in conjunction with Article VII(1), also considers as treaty claims the breaches of an investment agreement between

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<sup>147</sup> El Paso Energy Int’l Co., ICSID Case No. ARB/03/15, para. 81.

<sup>148</sup> *Id.* (internal quotation marks omitted).

<sup>149</sup> *Id.*

Argentina and a national or company of the United States.<sup>150</sup>

3.2.3. *Jurisdiction for Contract Claims Under Wide Dispute resolution clauses*

An alternative method for seizing a treaty tribunal with a contract claim is to argue the claim is an “investment dispute” within the general consent to arbitration of investment disputes under the treaty. The tribunal in *Salini v. Morocco* in July 2001<sup>151</sup> addressed the question of whether a contract claim should be considered an investment dispute under the Italy Morocco BIT referring to: “[a]ll disputes or differences, including disputes related to the amount of compensation due in the event of expropriation, nationalization, or similar measures, between a Contracting Party and an investor of the other Contracting Party.”<sup>152</sup> The tribunal held that this subject matter jurisdiction clause included jurisdiction for contract claims in principle although it ultimately rejected the contract claim at issue for other reasons. The tribunal reasoned: “[t]he reference to expropriation and nationalisation measures, which are matters coming under the unilateral will of a State, cannot be interpreted to exclude a claim based in contract from the scope of application of this Article.”<sup>153</sup>

The Vivendi Annulment Committee, considering the dispute resolution clause of the Argentine-U.S. BIT, stated as well:

Article 8 does not use a narrower formulation, requiring that the investor’s claim allege a breach of the BIT itself. Read literally, the requirements for arbitral jurisdiction in Article 8 do not necessitate that the Claimant allege a breach of the BIT itself: it is sufficient that the dispute relate to an investment made under the BIT.<sup>154</sup>

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<sup>150</sup> *Id.* para. 84. The Tribunal positively referenced the Model BIT in coming to this conclusion, but did not explain why.

<sup>151</sup> *Salini Costruttori S.p.A. v. Morocco*, Decision on Jurisdiction, ICSID Case No. ARB/00/4 (July 23, 2001).

<sup>152</sup> *Id.* para. 15 (quoting the Italy-Morocco BIT).

<sup>153</sup> *Id.* para. 59.

<sup>154</sup> *Compañía de Aguas del Aconquija S.A. v. Vivendi Universal* (formerly *Compagnie Générale Des Eaux*), Decision on Annulment, ICSID Case No. ARB/97/3, para. 55 (July 3, 2002).

As noted above, the SGS Pakistan Tribunal declined to read the same meaning into Article 9 of the Swiss-Pakistani BIT, which referred to “disputes with respect to investments.”<sup>155</sup> The Tribunal in SGS Philippines, in contrast, agreed with the claimant that the contract claims should also be included in the phrase “disputes with respect to investments” between a Contracting Party and an investor of the other Contracting Party.<sup>156</sup> The Tribunals in Fedax,<sup>157</sup> Impregilo,<sup>158</sup> Tokios Tokelés,<sup>159</sup> and Parkerings<sup>160</sup> came to similar conclusions.

3.2.4. *MFN and Contract Claims Jurisdiction: Impregilo, Salini v. Jordan*

While the application of an MFN clause to arbitration procedures under BITs in general continues to be highly controversial,<sup>161</sup> two tribunals have rendered decisions specifically on whether the investment tribunal had jurisdiction over contract claims by operation of an MFN clause. In both cases the Tribunals declined to accept this use of the MFN clause.

In *Impregilo v. Pakistan* an Italian company had entered into a contract for the construction of a barrage downstream of the Tarbela Dam with the Pakistan Water Power Development Authority (“WAPDA”). The claimant argued that it could claim the procedural benefit of arbitration of contract claims under an umbrella clause in another treaty through the Most Favored Nation clause in Article 3 of the Italy-Pakistan BIT. After determining WAPDA to be separate from the government of Pakistan under Pakistani law, the tribunal stated:

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<sup>155</sup> *SGS Pakistan*, Case No. ARB/01/13, paras. 149–50.

<sup>156</sup> *SGS Société Générale de Surveillance S.A. v. Philippines*, Decision on Jurisdiction, ICSID Case No. ARB/02/6, para. 134 (Jan. 29, 2004).

<sup>157</sup> *Fedax N.V. v. Venezuela*, Award, ICSID Case No. ARB/96/3 (Mar. 9, 1998).

<sup>158</sup> *Impregilo S.p.A. v. Pakistan*, Decision on Jurisdiction, ICSID Case No. ARB/03/3 (Apr. 22, 2005).

<sup>159</sup> *Tokios Tokelés v. Ukraine*, Award, ICSID Case No. ARB/02/18 (July 26, 2007).

<sup>160</sup> *Parkerings-Compagniet AS v. Lithuania*, Award, ICSID Case No. ARB/05/8 (Sept. 11, 2007).

<sup>161</sup> See Emanuel Gaillard, *Establishing Jurisdiction Through a Most-Favored-Nation Clause*, N.Y. L.J., June 2, 2005, at 37 (explaining the lack of consistency in case law decisions regarding the application of Most Favored Nation status clauses in the area of investment arbitration).

[G]iven that the Contracts were concluded by Impreglio with WAPDA, and not with Pakistan[,] Impregilo's reliance upon Article 3 of the BIT takes the matter no further. Even assuming *arguendo* that Pakistan . . . has guaranteed the observance of the contractual commitments into which it has entered together with Italian investors, such a guarantee would not cover the present Contracts—since these are agreements into which it has not entered.<sup>162</sup>

More significant for the present purposes is the holding of the Salini Tribunal, which considered the question of whether the right to ICSID arbitration of a contract could be awarded through a MFN clause despite a provision in the Jordan-Italy BIT mandating the use of the procedure set out in the contract (Article 9).<sup>163</sup> The claimant brought both treaty and contract claims related to a contract for the construction of the Karameh Dam between two Italian companies and the Ministry of Water and Irrigation-Jordan Valley Authority. According to the contract, the progress of the work and the amount charged therefore was to be certified by an Engineer appointed by the Ministry. The dispute resolution clause 67.3 of the contract concerned the situation when a dispute arose over the Engineer's finding. It specified arbitration was allowed if both parties agreed to arbitrate, provided the government party had to first obtain the approval of the Council of Ministers. When the parties differed by approximately U.S. \$28 million on the final amount owing under the Contracts, Salini requested arbitration under the aforementioned clause. When the Council of Ministers decided that the Jordanian Courts should hear the dispute instead of allowing it to go to arbitration, Salini brought a claim before ICSID under the BIT.

Salini had argued Article IX of the Jordan-U.S. BIT and Article 6 of the Jordan-United Kingdom BIT giving U.S. investors in Jordan "the right to submit investment disputes with the host State to ICSID regardless of any clause in the investment agreement providing for a different dispute settlement mechanism" made

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<sup>162</sup> *Impreglio*, ICSID Case No. ARB/03/3, para. 223 (citation omitted).

<sup>163</sup> *Salini Costruttori S.p.A.*, ICSID Case No. ARB/02/13, para. 19 (citing Agreement between the Government of the Italian Republic and the Government of the Hashemite Kingdom of Jordan on the Promotion and Protection of Investments, 17 July 2000, available at <http://www.agreements.jedco.gov.jo/main/doc/Italy96e.html>).

available to investors of the United States and UK "a dispute resolution clause which is more favorable" than that of the Jordan-Italy BIT.<sup>164</sup> Therefore, it argued the MFN clause Article 3 of the Jordan-Italy BIT allowed the claimant to submit the dispute to ICSID arbitration. Article 1 reads: "Both Contracting Parties, within the bounds of their own territory, shall grant investments effected by, and the income accruing to, investors of the Contracting Party no less favorable treatment than that accorded to investments effected by, and income accruing to, its own nationals or investors of Third States."<sup>165</sup>

The Tribunal endorsed the position of Jordan that the Contracts were investment agreements within the meaning of the Jordan-Italy BIT, Article 9(2) which required the disputes to use the procedure in the contract. Given this, the Tribunal could find no intent in the MFN clause of the treaty, nor evidence from the treaty practice to confirm that the parties intended dispute settlement to be included in the MFN clause to counter the specific intent expressed in the treaty's dispute resolution clause.<sup>166</sup>

### 3.2.5. *Another Perspective: Waiver of Treaty Arbitration*

In most of the cases above, the question of the jurisdiction of the arbitral Tribunal founded under an investment treaty to decide a contract claim for which a host-State forum has already been designated has been treated mainly as a question of treaty interpretation. The main question has been: has the Host State consented to treaty arbitration of the contract claim? Some tribunals have approached the issue from another perspective: has the investor waived treaty arbitration under international law, either expressly or impliedly by conduct, by recognizing another forum for dispute resolution?

As a general matter, the dual public/private nature of the rights under the BITs raises the question as to whether an individual is capable of waiving the public interests rights embodied in the treaty's arbitration procedures. If the right to investment treaty arbitration is held by the investor and the State of his or her nationality simultaneously, may an investor alone waive the State's right to demand treaty arbitration for its

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<sup>164</sup> *Id.* para. 20.

<sup>165</sup> *Id.* para. 66, art. 3.

<sup>166</sup> *Id.* para. 118.

investors?<sup>167</sup> To the extent that tribunals believe such a waiver possible, most require an explicit expression of waiver of ICSID arbitration to be effective.<sup>168</sup>

### 3.2.5.1. *Waiver by Committing to the Exclusive Forum Selection Clause*

Respondent States have argued that by committing to the bargained-for forum-selection clause in the contract when a BIT is already in existence, the investor has waived the right to related treaty arbitration. As noted in the cases above, this may be equally viewed as an expression of the principle of party autonomy or *pacta sunt servanda*, respected in both municipal and international law. In practice, however, tribunals seldom hold an investor has waived investment arbitration for breach of the treaty simply by entering into an exclusive forum-selection agreement in a contract. In this many Tribunals have followed the reasoning of the Vivendi I Tribunal. The Tribunal held that entering into a forum selection agreement as part of a contract could not constitute a waiver of treaty claims because the subject matter or cause of action of the claims was different.<sup>169</sup>

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<sup>167</sup> See Ole Spierman, *Individual Rights, State Interest and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties*, 20 ARB. INT'L 179, 206-08 (2004):

The question is whether the interests of the home state are sufficient to oppose party autonomy and deny the investor the power to waive international arbitration . . . . [T]he better view would seem to be that, unless the bilateral investment treaty contains an explicit provision to the contrary, there is a presumption that the investor has the power to waive international arbitration.

<sup>168</sup> *Aguas Del Tunari v. Bolivia (Aguas)*, ICSID Case No. ARB/02/3, Decision on Jurisdiction, para. 119 (Oct. 21, 2005); *Occidental Petroleum Corp. v. Ecuador (Occidental)*, ICSID Case No. ARB/06/11, Decision on Jurisdiction, para. 71 (Sept. 9, 2008) (citing *Aguas*, ICSID Case No. ARB/02/3, para. 119).

<sup>169</sup> See generally *Salini Construttori S.p.A. v. Morocco*, Decision on Jurisdiction, ICSID Case No. ARB/00/4, para. 49 (July 23, 2001); *Azurix Corp. v. Argentina*, Award, ICSID Case No. ARB/01/12, para. 79 (Dec. 8, 2003); *AES Corp. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/02/17 (Apr. 26, 2005); *Enron Corp. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/01/3 (Jan. 14, 2004); *CME Czech Republic B.V. v. Czech Republic (Neth. V. Czech. Rep.)*, Award, (UNICITRAL Mar. 2003), available at [http://ita.law.uvic.ca/documents/CME-2003-Final\\_001.pdf](http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf); *Suez, Sociedad General de Aguas de Barcelona, S.A. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/19 (Aug. 3, 2006); *CMS Gas Transmission Co. v. Argentina*, Award, ICSID Case No. ARB/01/8 (May 12, 2005).

Article 16.4 of the Concession Contract does not divest this Tribunal of jurisdiction to hear this case because that provision did not and could not constitute a waiver by CGE of its rights under Article 8 of the BIT to file the pending claims against the Argentine Republic. . . . [T]hose claims are not based on the Concession Contract but allege a cause of action under the BIT.

Thus, Article 16.4 of the Concession Contract cannot be deemed to prevent the investor from proceeding under the ICSID Convention against the Argentine Republic on a claim charging the Argentine Republic with a violation of the Argentine-French BIT.<sup>170</sup>

In the 1998 *Lanco* arbitration, the Tribunal rejected that argument that investors had waived treaty arbitration by entering into forum-selection clauses assigning the dispute to administrative courts of the province.<sup>171</sup> Even while the Tribunal found the Concession Agreement to be an “investment agreement” within the meaning of the dispute resolution clause of the treaty requiring the use of the procedure in the investment agreement,<sup>172</sup> it denied that such a forum-selection clause could express consent overriding ICSID jurisdiction, as administrative jurisdiction was not selectable under Argentine law.<sup>173</sup> Other tribunals such as the one in *Salini v. Morocco* have adopted *Lanco*’s reasoning to deny effect to exclusive forum selection clauses.<sup>174</sup>

### 3.2.5.2. *Express Waiver: Azurix and Aguas Del Tunari*

The Vivendi Annulment Committee opined that if a forum selection clause in a contract purports to exclude the jurisdiction of an international tribunal arising under the BIT, whether a

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<sup>170</sup> *Compañía de Aguas del Aconquija S.A. v. Argentina*, Award, ICSID Case No. ARB/97/3, paras. 53–54 (Nov. 21, 2000).

<sup>171</sup> *Lanco Int’l v. Argentina*, Preliminary Decision on Jurisdiction, ICSID Case No. ARB /97/6 (Dec. 8, 1998).

<sup>172</sup> *Id.* para. 20.

<sup>173</sup> *Id.* para. 19. An opposite view on exclusive forum selection clauses is provided in Crawford, *supra* note 66, at 13 (maintaining that a treaty tribunal may not adjudicate a claim over an exclusive foreign selection clause in a contract and that “[p]acta sunt servanda is not a one-way street”).

<sup>174</sup> *Salini Construttori S.p.A. v. Morocco*, Decision on Jurisdiction, ICSID Case No. ARB/00/4, para. 27 (July 16, 2001).



contractual claim or a treaty claim, a clear indication of intent to exclude jurisdiction would be required.<sup>175</sup> The Azurix case<sup>176</sup> considered whether express waiver of all other fora in the contractual documentation for the bidding for a water purification project pursuant to a privatization plan precluded ICSID jurisdiction. Azurix's request for arbitration alleged multiple violations of the U.S.-Argentina BIT but no contract claims.

Argentina objected to jurisdiction on the grounds that all of the contractual documentation relating to the investment provided "for all disputes that may arise out of the bidding" an express waiver of "any other forum, jurisdiction or immunity that may correspond." This waiver was annexed to each of the respective forum selection clauses that committed to the exclusive jurisdiction of the courts of contentious administrative matters of the city of La Plata.<sup>177</sup> Argentina also objected that a Clarification Circular by the Privatization Commission had affirmed to some bidding participants that the forum selection clause in the documents were an express waiver of ICSID jurisdiction.<sup>178</sup>

Azurix argued, *inter alia*, that the two claims were based on different sources of rights, and that if it had made a waiver, it was only concerning contractual rights, not claims.<sup>179</sup> It also objected on the grounds that the Argentine Republic was not a party to the Concession Agreements. Azurix also observed that Argentina's court structure in any case precluded Azurix from bringing a BIT claim in provincial courts, while Article VII(2) of the BIT the dispute resolution clause allowed the investor to choose between national courts, a previously agreed upon forum or ICSID arbitration.<sup>180</sup>

The Azurix tribunal held that the inclusion of an express waiver "has not made a substantive difference to the exclusive forum clause included in the concessions agreements considered by ICSID Tribunals in *Lanco* or *Vivendi I*, since the acceptance of the

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<sup>175</sup> *Compañía de Aguas del Aconquija S.A. v. Argentina*, Decision on Annulment, ICSID Case No. ARB/97/3, para. 76 (July 3, 2002), *reprinted in* 6 ICSID (W. Bank) 340 (2004).

<sup>176</sup> *Azurix*, ICSID Case No. ARB/01/12.

<sup>177</sup> *Id.* para. 26.

<sup>178</sup> *Id.*

<sup>179</sup> *Id.* para. 32.

<sup>180</sup> *Id.* para. 35.

exclusivity of a forum implies by definition the renunciation of any other fora whether or not explicitly stated in the clause.”<sup>181</sup> Furthermore, the Tribunal points out “that the rights under the Concession Agreement and under the BIT are not the same and that the generality of the waiver would exclude even the courts at the federal level which would normally be competent to consider claims against the Respondent.” The court ultimately holds that the waiver does not apply to the claim Azurix brought before the tribunal.

On the other hand, the Aguas del Tunari Tribunal<sup>182</sup> distinguished express waivers and exclusive forum selection clauses in its analysis.<sup>183</sup> In principle, the Tribunal considered that if the host State and the investor agreed separately to waive ICSID arbitration expressly, such a waiver would be effective.<sup>184</sup> As to exclusive forum selection clauses, following the *Vivendi Ad Hoc* Committee, the Tribunal denied that a forum-selection clause could affect the jurisdiction of a BIT tribunal. “The Tribunal is of the view that it is not the existence of the exclusive forum selection clause that would be given effect by an ICSID tribunal, but rather that the tribunal could, at most, give effect to a waiver implied from the existence of an exclusive forum selection clause.”<sup>185</sup> After accepting the Claimant’s argument that the clause in the Concession Contract at issue was not a true forum selection agreement specifically excluding other fora, in dicta it went on to opine that an exclusive forum selection clause could at least arguably be deemed a waiver of treaty arbitration, provided that it must deal with “the same matters and Parties and contain conflicting obligations.”<sup>186</sup> But an exclusive forum selection clause alone would need separate, more conclusive proof of the parties’

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<sup>181</sup> *Id.* para. 80.

<sup>182</sup> *Aguas Del Tunari v. Bolivia (Aguas)*, Decision on Jurisdiction, ICSID Case No. ARB/02/3 (Oct. 21, 2005) (holding that there is not sufficient evidence to support an allegation of abuse of corporate form or fraud).

<sup>183</sup> *Id.* para. 118.

<sup>184</sup> *Id.* Para 114 n.89 (citing Article 26 of the ICSID convention as proof that this was the prevailing view at the time of the Washington Convention after *Spiermann*).

<sup>185</sup> *Id.* para. 119.

<sup>186</sup> *Id.* para. 111.

intent for the Tribunal to infer a waiver.<sup>187</sup> “A separate conflicting document should be held to affect the jurisdiction of an ICSID Tribunal only if it clearly is intended to modify the jurisdiction otherwise granted to ICSID.”<sup>188</sup>

### 3.2.5.3. *Treaty-Based Waiver: Fork-in-the-Road Clauses*

The waiver question also arises when an investor has actually submitted the dispute to the designated forum before invoking treaty arbitration. In many cases, a treaty may explicitly provide that a waiver will be deemed when an investor submits an investment dispute to a national court under the treaty’s “fork-in-the-road” clause. Intended to promote finality of decisions in the two separate systems of law, municipal and international,<sup>189</sup> a fork-in-the-road clause says that once an investor has submitted a claim to domestic tribunals, the investor has made a final election and has waived his or her right to bring the claim to treaty arbitration and vice versa. In the main, the investment treaty arbitral decisions have required identity of parties, subject matter and causes of action to give effect to a fork-in-the-road clause in a treaty.<sup>190</sup> Thus, these tribunals have held that a prior submission of a contract claim would not cause a treaty claim to be waived.

### 3.3. *Conclusion*

From the foregoing we see that attempts by investors to recover on breach of contract claims against host States under BITs have met scarce success. BIT tribunals have mainly broadly justified denying contract claims jurisdiction in terms of traditional public international law and treaty interpretation, imposing a high bar to

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<sup>187</sup> See *id.* paras. 118–19 (explaining that, absent an indication of the parties’ specific intent to waive jurisdiction, ICSID has the “duty” to exercise jurisdiction).

<sup>188</sup> *Occidental Petroleum Corp. v. Ecuador (Occidental)*, Decision on Jurisdiction, ICISD Case No. ARB/06/11, para. 71 (Sept. 9, 2008).

<sup>189</sup> See, e.g., *Champion Trading Co. v. Egypt*, Award, ICSID Case No. ARB/02/09 (Oct. 21, 2003) (finding that a prior submission activated fork-in-the-road clause).

<sup>190</sup> See, e.g., *Compañía de Aguas del Aconquija S.A. v. Argentina (Vivendi Annulment)*, Decision on Annulment, ICSID Case No. ARB/97/3, para 113 (July 3, 2002), reprinted in 19 ICSID REV.: FOREIGN INVESTMENT L.J. 89 (2004) (discussing fork-in-the-road clause); *Azurix*, ICSID Case No. ARB/01/12, paras. 87–90 (stating that the identity of parties, object, and cause of action were required to trigger the fork-in-the-road provision).

find State consent for such arbitrations. Umbrella clauses and general dispute resolution clauses have often been found to be too vague to justify independent contract claims jurisdiction in the face of the predicted impact on the integrity and stability of the international and domestic legal orders, the burden on respondent States, and the renunciation of judicial authority by the host State that would be implied by such an interpretation of the BIT.

As the presentation below of the key provisions on the arbitration of investment agreement shows, the Model BIT attempts to anchor jurisdiction for treaty arbitration of concession contracts within this legal discourse while presenting a compromise to the full internationalization of State contracts. And yet, such a compromise is likely to raise similar objections as those raised by the tribunals above to contract claims jurisdiction, along with other, new ones, which will be discussed in the section that follows.

#### 4. INVESTMENT AGREEMENT CLAIMS UNDER THE 2004 U.S. MODEL BIT: AN UNEASY COMPROMISE?

Contrary to the current practice in treaty arbitration discussed above, in the U.S. Model BIT, the United States has put forth a procedural mechanism specifically to arbitrate concession agreement claims in investment treaty tribunals through the standing offer of consent to arbitrate in the DRC. Although it is too early to say whether the text of the investment agreement provisions is likely to become as widely adopted in other investment treaties as the umbrella clause has been, considering the recent dynamic ongoing growth of BITs and FTAs particularly in Asia, counterparties to treaties with these clauses should carefully consider the wording of the DRC.

In drafting BITs, a principal problem for States is how much protection for investors is necessary to induce foreign investment for economic growth without sacrificing too much sovereign policy discretion. Also of special concern these days is unduly exposing the State to expensive litigation. As demonstrated by the \$128 million award against Argentina for violating treaty commitments *inter alia* the umbrella clause in September 2007,<sup>191</sup> the balancing game played by States concluding investment treaties is

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<sup>191</sup> *Sempra Energy Int'l v. Argentina* (Sempra Award), Award, ICSID Case No. ARB/02/16 (Sept. 28, 2007).

increasingly fraught with peril. Considering these stakes, it is noteworthy then that the United States has chosen to delegate its judicial powers to private arbitrators for investment agreement claims as set out in the treaty's dispute resolution clause, thereby constraining its policy options in this area of potentially strong public interest. Whether the outcome will be consistent with the stated overall goal of the Model BIT of promoting a "stable framework for investment,"<sup>192</sup> is far from clear.

#### *4.1. The Structure of the 2004 U.S. Model BIT*

The Model BIT was devised to either stand alone as a bilateral investment treaty or constitute an investment chapter of a comprehensive Free Trade Agreement. The key substantive obligations described in Section A are as follows:

National treatment (Article 3); Treatment no less favorable than that of the investors of the most favored-nation (MFN Article 4); Free transfer of profits (Article 7); Minimum standard of treatment for investors and investments under customary international law (including fair and equitable treatment and full protection and security) (Article 5); and Fair market value compensation in case of legal expropriation (Article 6)<sup>193</sup>

#### *4.2. The Dispute Resolution Clause: The Agreement to Arbitrate for Investment Agreement Claims*

The procedural conditions for the States' consent to arbitrate an investment dispute are set out in Article 26. Article 26 requires a claim to take place within three years of when the claimant first acquired, or should have first acquired knowledge of the breach.<sup>194</sup> It also declares a six-month waiting period and sets out certain notification requirements before bringing the claim.

##### *4.2.1. The Subject Matter Jurisdiction Clause*

Article 24 of the Model BIT authorizes three types of claims which may be claimed alone or together: a breach of a substantive

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<sup>192</sup> Model BIT, *supra* note 3, pmb1.

<sup>193</sup> Model BIT, *supra* note 3, Sec. A.

<sup>194</sup> *Id.* art. 26.

obligation under Article 24(1)(a)(i)(A) and a breach of an investment agreement under Article 24(1)(a)(i)(C) or investment authorization<sup>195</sup> under Article 24(1)(a)(i)(B). A claim may be made by the claimant on his own behalf or "on behalf of an enterprise of the respondent that is a juridical person that the claimant owns or controls directly or indirectly."<sup>196</sup> In contrast to treaty claims under Article 24(1)(a)(i)(A), a breach of an investment agreement claim clearly refers to a type of claim that can be considered contractual.<sup>197</sup> An investment authorization, bearing formal resemblance to a license, can be considered an explicit assurance regarding an investment. There are no limitations on whether the two types of claims may be raised independently or in combination.

#### 4.2.2. *Claims for Breach of an Investment Agreement*

##### 4.2.2.1. *Definition of Investment Agreement*

An investment agreement is a written agreement<sup>198</sup> with a national authority<sup>199</sup> that grants rights to the covered investment or investor:

- (a) with respect to natural resources that the national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale;

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<sup>195</sup> See *id.*, art. 1 ("Investment authorization' means an authorization that the foreign investment authority of a Party grants to a covered investment or an investor of the other Party.").

<sup>196</sup> *Id.* art. 24(1)(b).

<sup>197</sup> See also Crawford, *supra* note 66, at 15 (discussing breach of contract claims).

<sup>198</sup> Model BIT, *supra* note 3, Section A, n.4:

[A] written agreement refers to an agreement in writing . . . that creates an exchange of rights and obligations, binding on both parties under the law applicable under Article 30[Governing Law](2). For greater certainty, (a) a unilateral act of an administrative or judicial authority, such as a permit, license or authorization issued by a Party solely in its regulatory capacity, a decree, order or judgment, standing alone; and (b) an administrative or judicial consent decree or order, shall not be considered a written agreement.

<sup>199</sup> "For purposes of this definition, 'national authority' means (a) for the United States, an authority at the central level of government . . ." *Id.* Sec. A, n.5.

(b) to supply services the public on behalf of the Party, such as power generation or distribution, water treatment or distribution or telecommunications; or

(c) to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government.<sup>200</sup>

#### 4.2.2.2. *The Underlying Qualified Investment Requirement*

As a threshold matter, a claim for the breach of an investment agreement must relate directly to a qualified investment that was acquired in reliance on the investment agreement and that was harmed as a result of the breach of the investment agreement.<sup>201</sup> The definition of investment specifies loosely some typical characteristics of investments for which a broad array of assets may qualify.

Investment means “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.”<sup>202</sup>

This is supplemented by a non-exhaustive list of “forms that an investment might take,” including certain types of contract rights:

(a) an enterprise;

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<sup>200</sup> Model BIT, *supra* note 3, art. 1.

<sup>201</sup> A qualification to Article 24’s subject matter jurisdiction clause reads:

Provided that a claimant may submit pursuant to subparagraph (a)(i)(C) or (b)(i)(C) a claim for breach of an investment agreement only if the subject matter of the claim and the claimed damages directly relate to the covered investment that was established or acquired, or sought to be established or acquired, in reliance on the relevant investment agreement.

*Id.* art. 24. This appears to harmonize the investment agreement clause with the requirements of Article 25(1) of the ICSID convention that confers jurisdiction to the ICSID Tribunal to “legal disputes arising directly out of an investment.” ICSID Convention, *supra* note 7, art. 25(1).

<sup>202</sup> Model BIT, *supra* note 3, art. 1.

- (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, authorizations, 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.<sup>203</sup>

While some forms are “more likely to have the characteristics of an investment,” other forms “such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics.”<sup>204</sup>

Of special significance to countries with federal systems is the fact, that although an investment agreement may be entered into only with the national government, an action by a local government, such as a refusal to issue a permit, could be the cause of the breach of the investment agreement by the national government. In such cases, the claim might still be maintained against the national government under Article 4 of the ILC Articles on State Responsibility.<sup>205</sup> Another notable aspect is that there is no threshold showing of harm required to prove a breach of an investment agreement requiring compensation.

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<sup>203</sup> *Id.*

<sup>204</sup> *Id.* art. 1.

<sup>205</sup> See *Metalclad Corp. v. Mexico (Metalclad)*, Award, ICSID Case No. ARB(AF)/97/1, para. 73 (Aug. 30, 2000) (explaining that this was the scenario in *Metalclad*’s expropriation claim against Mexico).



4.2.2.3. *Conditions and Limitations to Bringing a Claim:  
Waiver of Domestic Litigation*

In either type of claim, Article 26 requires a claimant to provide along with a 90-day prior written notice of intent to arbitrate a written waiver of “any right to initiate or continue before any administrative Tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24.”<sup>206</sup>

This important clause performs a similar function to the *lis pendens* doctrines in domestic law requiring a Tribunal to abstain from taking up a case that is currently being litigated and preventing the claimant from engaging in parallel litigation. Claimants may continue to request injunctive relief only, “provided that the action is brought for the sole purpose of preserving the claimant’s or the enterprise’s rights and interests during the pendency of arbitration.” However, in contrast to the *lis pendens* doctrine requiring only identity of parties, cause of action, and subject matter, this provision encompasses all related claims arising from the challenged government measure.

4.2.2.4. *Governing Law of Investment Agreement Claims*

The Governing Law Article 30 covering the substantive law of the arbitration states that if the claim is for a breach of an investment agreement, the Tribunal “shall apply:”

- (a) the rules of law specified in the pertinent investment authorization or investment agreement, or as the disputing parties may otherwise agree; or
- (b) if the rules of law have not been specified or otherwise agreed:
  - (i) the law of the respondent, including its rules on the conflict of laws, and

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<sup>206</sup> Model BIT, *supra* note 3, art. 26(2)(b)(ii).

(ii) such rules of international law as may be applicable.<sup>207</sup>

Thus placing heavy reliance on the principle of party autonomy, an investment agreement claim will be decided by “the rule” as agreed upon by the parties to the contract. The term “the rule” is broad enough to include, as sources of decision, the law of a country, public international law, or another system such as the *lex mercatoria* or the UNIDROIT Principles of International Commercial Contracts.

The extent to which international law is applicable in the unlikely case that the rules of law have not been agreed to is within the discretion of the tribunal. In this context, the drafters of this clause on the governing law of the investment agreement arbitration appear to have drawn on ICSID Article 42(1), which provides:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.<sup>208</sup>

A debate has long existed about the second sentence of ICSID Article 42(1), as to whether international law should operate only if there is a lacuna in domestic law or whether it should operate as a corrective to domestic law.<sup>209</sup> Some commentators interpret “and” to mean that the tribunal is mandated to apply both domestic and international law. Tribunals have frequently adopted this

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<sup>207</sup> *Id.* art. 30(2). In the case of a breach of a substantive obligation, the dispute shall be decided “in accordance with this Treaty and the applicable rules of international law.” *Id.* art. 30(2).

<sup>208</sup> ICSID Convention, *supra* note 7, art. 42(1).

<sup>209</sup> See generally, Emmanuel Gaillard & Yas Banifatemi, *The Meaning of “And” in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process*, 18 ICSID REV.: FOREIGN INVESTMENT L.J. 375 (2003) (discussing choice of law under Article 42(1)); Domenico Di Pietro, *Applicable Law under Article 42 of the ICSID Convention: The Case of Amco v. Indonesia*, in INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM ICSID, NAFTA BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW 223 (Todd Weiler ed., 2005) (examining the increasing role of public international law in resolving investment disputes).

concurrent approach and used international law to resolve certain issues in disputes over agreements governed by domestic law.<sup>210</sup> Recently under the influence of the Vivendi holding, “an issue specific” approach has been advocated. Where the claim raised by the parties concerns a right or obligation defined under domestic law, domestic law will be used, and where the right or obligation arises under international law, international law will be used.<sup>211</sup> Regardless of the approach adopted by the Tribunal, it is clear that the tribunal is obligated at a minimum to identify the issue, the law applied, and the outcome of the analysis.<sup>212</sup>

However, the award will not be annulled for errors in application of the law.

[A] tribunal’s disregard of the agreed rules of law would constitute a derogation from the terms of reference within which the tribunal has been authorized to function . . . .

Disregard of the applicable rules of law must be distinguished from erroneous application of those rules which, even if manifestly unwarranted, furnishes no ground for annulment.<sup>213</sup>

#### 4.2.3. *The Award Clause*

The Model BIT’s Article 34(1) permits the Tribunal to award separately or in combination, only

(a) monetary damages and any applicable interest; and

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<sup>210</sup> CME Czech Republic (Neth. v. Czech Rep.), UNCITRAL Arb., paras. 167–91, U.N. Doc. 403/LERMERK/2001 (2001); LG&E v. Argentina, Decision on Liability, ICSID Case No. ARB/02/1, para. 93 (Oct. 3, 2006) (stating that obviating the application of international law would mean ignoring that “international treaties move away from the principle according to which foreign investment is subject to the law and jurisdiction of the host state and seek international solution of conflicts”).

<sup>211</sup> The award of the Tribunal in *Duke Energy*, which found a violation of an umbrella clause and of the fair and equitable treatment obligation, exemplifies this approach. See *Duke Energy Electroquil Partners v. Ecuador* (Duke Energy), ICSID Case No. ARB/04/19, paras. 315–488 (Aug. 18, 2008).

<sup>212</sup> CME Czech Republic, para. 197 (discussing the consequences of applying improper law).

<sup>213</sup> CMS Gas Transmission Co. v. Argentina, Annulment Decision, ICSID Case No. ARB/01/8, para. 50 (Sept. 25, 2007).

- (b) restitution of property, in which case the award shall provide that the respondent may pay monetary damages and any applicable interest in lieu of restitution.

A Tribunal may also award costs and attorney's fees, while punitive damages are specifically disallowed.<sup>214</sup> The award clause does not distinguish between treaty and investment agreement claims. In fact, it is not clear that the award clause applies to a breach of an investment agreement claim at all if the governing law of the investment agreement is host state law.

In the BIT arbitrations with concurrent treaty and contract claims so far, remedies from the treaty damage clause were only allowed on a showing of a violation of international law.<sup>215</sup> Does the injunction to use "the rule" in the investment agreement to decide the claim extend to the calculation of damages? In the case that the investment agreement itself refers to liquidated damages or incorporates statutory remedies, is the tribunal constrained to award damages according to the "rule" in the investment agreement itself to the exclusion of damages under the award clause? Since the private party recovery under public contracting laws is typically significantly less than for commercial contracts, the difference could be considerable.<sup>216</sup>

Investors could claim damages for an investment agreement claim as extensive as the full market value of the investment as measured by present discounted value of future profits, which roughly corresponds to expectation damages for private contracts under "general principles of international law." This is another area where the investment agreement claims provisions will inject uncertainty into investment arbitration.

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<sup>214</sup> Model BIT, *supra* note 3, art. 34(3) ("A tribunal may not award punitive damages").

<sup>215</sup> See *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6 (Jan. 24, 2004) (involving a legal dispute between a foreign investor and a host state); *Wena Hotels Ltd. v. Arab Republic of Egypt*, Award on Merits, ICSID Case No. ARB/98/4 (Dec. 8, 2000) (involving a dispute that arose from obligations to develop and manage two hotels).

<sup>216</sup> See Bowett, *supra* note 40, at 50 (comparing international standards of compensation for expropriation with U.S. laws on the termination of public contracts).

#### 4.2.3. Summary

The provisions on investment agreements in the DRC give rise to simultaneous duties of signatory States as follows:

- 1) Each State owes to qualified investors of the other treaty party a duty to arbitrate an investment agreement claim when the investor perfects consent by the terms of the treaty;
- 2) Each State owes a duty to the other Treaty party as a Treaty obligation to not interfere with the arbitration and provide for recognition of the award and enforcement when applied for on the State's territory; and
- 3) Each State is obliged to afford compensation for a breach of an investment agreement to investors of the other party.<sup>217</sup>

To raise an investment agreement claim, a qualified investor must show that there was a breach of a contract between an investor and a State granting rights to provide public services, develop natural resources or build infrastructure for public use. The investor must have made a qualified investment in reliance on the investment agreement; and the claim must relate directly to harm to the underlying investment caused by the breach of the investment agreement.

Is a breach of an investment agreement an international wrongdoing under the DRC? It can be argued that the treaty parties intended that a breach of an investment agreement would engage State responsibility following the reasoning of the *Impreglio*, *El Paso* and *PAE* cases, because the definition of investment agreements corresponds to contracts concluded by the State exercising specifically sovereign powers, such as granting rights to natural resources or to offer public services.<sup>218</sup> However,

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<sup>217</sup> Model BIT, *supra* note 3, arts. 23–36.

<sup>218</sup> See *El Paso Energy Int'l Co. v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/15 (Apr. 27, 2006) (involving a case wherein an umbrella clause was interpreted as extending treaty protection to special “investment protections contractually agreed by the State as sovereign”); *Pan Am. Energy LLC v. Argentina*, Preliminary Objections, ICSID Case No. ARB/04/18 (July 27, 2006) (holding that the contested provision in the agreement could not be considered an

this conclusion would not be warranted. First, the main reason for singling out and explicitly defining investment agreements must be to eliminate any ambiguity as to the State's consent to the relinquishment of sovereign authority over the adjudication of these contracts traditionally in the realm of domestic adjudication. Secondly, the DRC's structure separating the investment agreement claim provisions from the substantive obligation section of the treaty obviates any inference of State responsibility for breach of an investment agreement. Finally, it is hard to find support for such a theory in customary international law, which has tended to emphasize the nature of the act causing the breach rather than the nature of the contract at issue.<sup>219</sup> Neither would such an interpretation accord with the majority opinion in treaty tribunals.

Even though the investment agreement provisions do not automatically invoke State responsibility in international investment agreement claims, overall they represent a compromise<sup>220</sup> on the internationalization issue. The investment agreement prong of the subject matter jurisdiction clause embodies the modern version of the umbrella clause whose purpose is to externalize concession contract claims from host State judicial processes. Moreover, using a general formulation for breach of an investment agreement originally derived for any kind of ICSID investment dispute, the governing law clause authorizes tribunals to substitute international law for domestic law to certain aspects of the investment agreement claim. In as much as investment tribunals have largely prevented the application of international law to concession contracts by rejecting contract claims altogether in investment treaty arbitration, the governing law clause marches one step further down the road of internationalization of State contracts. This compromise will leave the door open for investors and their lawyers to further explicate the body of transnational law for State contract claims in opposition to doctrines upholding the

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umbrella clause which would change contract claims into breaches of international law).

<sup>219</sup> See Amerasinghe, *supra* note 52, at 884 (describing state breaches of contracts with aliens).

<sup>220</sup> See Crawford, *supra* note 66, at 3, 20 (describing the Model BIT's DRC as the "the integrationist approach" to international law).

sovereignty of States in public contracting and the disposition of natural resources.<sup>221</sup>

#### *4.3. A Short List of Issues Raised for Arbitral Tribunals*

The investment agreement provisions present an acute case of what Zachary Douglass has described as a “symmetrical jurisdictional conflict.”<sup>222</sup> A symmetrical jurisdictional conflict occurs when a treaty tribunal exercises jurisdiction over a claim with a cause of action in municipal law. In contrast to previous cases with concurrent treaty and contract claims, these cases asserting a breach of an investment agreement may involve an identity of party, claim and subject matter with a domestic contract claim. Consequently, tribunals will be faced with conflicting legal mandates that have not been dealt with directly in treaty arbitration before.

##### *4.3.1. Forum Selection Clauses*

For example, what effect should be given the designation of a home State forum for resolution of disputes in the investment agreement when the triple identity conditions are satisfied? With no express clarification that the treaty overrides forum selection clauses in investment agreement claims, the text of the DRC is generally inconclusive as to the treatment of such clauses. A case can be made that the tribunal should honor the forum in the dispute resolution of the investment agreements as the consensually agreed upon “rule” of the investment agreement. In support of this approach, the fundamental basis of an investment agreement claim is a contract: under the reasoning of the Vivendi Ad Hoc and the Woodruff Tribunals, the claim should be submitted to the forum designated in the contract and the investment treaty tribunal would lack jurisdiction. If the tribunal takes the position that its jurisdiction cannot be abrogated by a matter of municipal law because this might allow the home State to evade its international law obligation to arbitrate the investment

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<sup>221</sup> See *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, para. 36 (Sept. 9, 2008) (demonstrating that, in addition to the doctrine of permanent sovereignty over resources, host States have also mounted defenses, mostly unsuccessfully, based on mandatory laws forbidding the commercial arbitration of public contracts).

<sup>222</sup> Douglas, *supra* note 64, at 241–56.

agreement claim, then the investor should be held to have waived treaty arbitration. This logically follows because with the triple identity condition met, there should be no need for an explicit waiver of the investment agreement claim. From this perspective, a designation of a home State tribunal in the forum selection clause would call for a stay, as in the *SGS Philippines* case.<sup>223</sup>

On the other hand, in countries where administrative resolution in domestic courts is not selectable or is part of the mandatory laws of the host State, claimants may argue (as in *Occidental Petroleum*) that the forum-selection clause cannot express consent.<sup>224</sup> In this case, the DRC could be viewed as the only true expression of consent (the rule “as otherwise agreed” under the governing law clause) and as *lex specialis*. Under this reasoning, the tribunal would be bound to take up the investment agreement claim in spite of a forum selection clause.

#### 4.3.2. *Consideration of Previous Decisions by National Courts*

Another critical legal issue the tribunal will face for the first time is whether a tribunal exercise its jurisdiction over an investment agreement claim when a national tribunal has already rendered a decision on the same contract dispute, and if so, under what conditions? The 2004 Model BIT does not contain a “fork in the road” clause, and although some treaties relying on it such as the Korean-United States Free Trade Agreement have incorporated such clauses, investment agreement claims are expressly not covered. By omission, the DRC would seem to allow a “second bite” for previously litigated investment agreement claims in some situations. Provided the conditions of the domestic waiver requirements of Article 11.18 are met, if the investment agreement claim has already been dealt with in a domestic forum, the DRC does not by itself bar alternative treaty tribunal jurisdiction over the investment agreement claim.

However, for an international tribunal to assume concurrent jurisdiction over such a contract claim without allowing the exhaustion of domestic remedies is contrary to customary international law.

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<sup>223</sup> See *id.* at 283 (discussing “stay test” based on whether the “fundamental basis of the claim” is an investment contract or a treaty).

<sup>224</sup> See *Occidental Petroleum Corp.*, ICSID Case No. ARB/06/11, para. 36 (examining the Tribunal’s claims to jurisdiction over the case).



When the act complained of is a breach of local law only, then it is only the subsequent conduct of the state of the forum which can create responsibility. If the authorities there interfere with the course of justice or certain standards are not observed, then a denial of justice has occurred and responsibility results from it.<sup>225</sup>

In treaty arbitration practice, although the ICSID convention provides that the participant States have waived the domestic remedies requirement, tribunals have nevertheless been generally hesitant to review the decisions of domestic courts on matters of domestic law at any stage of litigation. Two cases in particular illustrate this point.<sup>226</sup>

In the *Lowen* case, the claimant alleged a denial of justice under NAFTA's minimum standard of treatment provision Article 1105 when the Mississippi Supreme Court required the claimant to post 125% of the judgment to stay the execution of an adverse award, in this case amounting to \$625 million dollars. The treaty tribunal rejected the claimants' allegation of denial of justice because the Mississippi court order lacked the requisite "finality of action" that would allow for it to assume jurisdiction over the claim. In other words, because the claimant had not sought U.S. Supreme Court review, the treaty tribunal would not consider the denial of justice claim.<sup>227</sup>

In the *Mondev* case, a claimant similarly claimed a breach of the obligation to provide the minimum standard of treatment required by NAFTA Article 1105 based on rejection of its claims in the domestic court system. When a real estate developer that Mondev came to own filed suit against the City of Boston and Boston Redevelopment Authority over a real estate assessment a contract, the Massachusetts court dismissed the claim holding that the Boston Redevelopment Authority had sovereign immunity. In contrast to the *Lowen* case, however, the decision of the

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<sup>225</sup> BROWNLEE, *supra* note 49, at 497.

<sup>226</sup> See Benjamin Klafter, *International Commercial Arbitration as Appellate Review: NAFTA Chapter 11, Exhaustion of Local Remedies and Res Judicata*, 12 U.C. DAVIS J. INT'L L. & POL'Y, 409, 417-29 (2006) (presenting the *Lowen* and the *Mondev* cases as instances wherein tribunals refused to review domestic court decisions).

<sup>227</sup> See *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB (AF)/99/2, para. 144 (Oct. 11, 2002) (discussing the international jurisprudence on the immunities of public authorities).

Massachusetts Supreme Judicial Court was final under U.S. law and the claimant had exhausted all remedies in the U.S. Court System. Deferring to the Massachusetts court, the NAFTA Tribunal stated:

[I]t is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State. Under NAFTA, parties have the option to seek local remedies. If they do so and lose on the merits it is not the function of NAFTA tribunals to act as courts of appeal.<sup>228</sup>

The Tribunal went further, saying that “[w]ithin broad limits, the extent to which a State decides to immunize regulatory authorities from suit for interference with contractual relations is a matter for the competent organs of the State to decide.”<sup>229</sup>

These decisions underscore the delicate balance treaty tribunals must strike when confronted with jurisdictional conflicts. The matter is much more complicated when both the domestic tribunal and the treaty tribunal have concurrent jurisdiction over a contract claim. Although *res judicata* is recognized in both municipal and international law, international law tribunals are not required to give *res judicata* effect to municipal law decisions. If a treaty tribunal assumes jurisdiction over an investment agreement claim based on a contract governed by domestic law, even if it exercises strong deference to the decisions of national tribunals, it is unlikely it can avoid theoretical conflict entirely. Because tribunals will be applying an uncertain mix of international and domestic law in an area traditionally reserved for domestic law under the relatively lax standards of review in the investment arbitration system, the provisions could produce conflicting and unstable outcomes in fairly common investment situations for some time. With these consequences, a strong international policy argument can be made that tribunals should not take up previously litigated investment agreement claims: 1) unless or until a treaty claim such as denial of justice is simultaneously claimed or 2) the parties originally

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<sup>228</sup> *Id.* para. 126 (proposing that the exhaustion of domestic remedies rule be introduced NAFTA arbitration); see also Gus van Harlen & Martin Coughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L., 121, 121-50 (2006) (asserting that investment treaty arbitration is a powerful form of international administrative law review).

<sup>229</sup> *Mondev Int'l Ltd.*, ICSID Case No. ARB/(4f)/99/2 para. 154.

specified international arbitration under international law in the investment agreement.

4.3.3. *The Relationship between the Investment Agreement Breach and Treaty Breaches*

Arbitral tribunals will have to consider what role the Treaty Parties expected the investment agreement claims to play in relationship to the other substantive obligations for investor protection set out in the treaty. Considering the many cases<sup>230</sup> in which concession contract investors have successfully protected their legitimate investment-backed expectations concerning their concession project by asserting a breach of fair and equitable treatment, there is a clear need in applying the investment agreement claims to distinguish them from the other treaty protections in the international law context. In contemporary investment treaty practice, a claim for fair and equitable treatment covers both a denial of justice and a discriminatory breach of an investment agreement. Since the breach of an investment agreement is not per se internationally wrongful, one such distinction may be the applicability of the treaty's damage award clause to the respective types of claims. In the following Section, I argue the preferable interpretation is one that limits the relief that an investor claiming a breach of an investment agreement may receive under the award clause to breaches that amount to clear violations of international law or the treaty provisions. Additionally, the investment agreement claim provisions may under some conditions grant some additional protection to investors when States have committed to a valid stabilization clause in the investment agreement.

5. INVESTMENT AGREEMENT CLAIMS AND THE POLICE POWERS OF STATES

As discussed above, under the broadest interpretation, investment agreement provisions would make any government action in violation of the investment agreement that impose financial burdens on a related investment a form of compensable liability. The definition of investment is broad enough to ensnare unwary governments in unexpected and expensive treaty

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<sup>230</sup> See cases cited *supra* note 85 (involving jurisdictional decisions regarding breach of contract claims).

arbitration litigation for run-of-the-mill environmental regulation. Considering the competitive pressures developing country States face to induce multinational foreign investment and the amount of money at stake in investment arbitration relative to the fiscal resources of such States, these treaty commitments are likely to substantially hinder the already weak enforcement of environmental and health regulation in developing States that become signatories. But should governments be expected to waive their rights to respond to scientific discoveries concerning health and the environment over many decades for fear of punitive investment arbitration?

*5.1. Expropriation and Non-Discriminatory Regulation in Investment Treaty Arbitration*

*5.1.1. Experience prior to the U.S. Model BIT*

NAFTA purports to address environmental concerns in Article 12 (also in the U.S. Model BIT):

Article 12: Investment and Environment. The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for the establishment, acquisition, expansion or retention of an investment in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultation with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

2. Nothing in this treaty shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise inconsistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

This language did not stem the cascade of investor claims challenging environmental or health regulations as indirect expropriations or as breaches of the obligation of fair and equitable treatment,<sup>231</sup> most often for indirect expropriation. (Nor have these clauses figured much in those arbitrations.) The line between compensable indirect expropriations and non-compensable regulation is not clear in international law: not all regulations may be considered indirect expropriations.<sup>232</sup> In particular, much authority supports the conclusion that in order to be found a compensable expropriation, a regulation must contain a discriminatory element.

Article 1 of the Protocol 1 to the European Convention on Human Rights states:

Every natural or legal person is entitled to the peaceful enjoyment of its possessions. No one should be deprived of

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<sup>231</sup> See SCOTT SINCLAIR, CANADIAN CTR. FOR POL'Y ALTERNATIVES, NAFTA CHAPTER 11 INVESTOR-STATE DISPUTES (2008); see also U.S. DEP'T OF STATE, NAFTA INVESTOR-STATE ARBITRATIONS, <http://www.state.gov/s/l/c3439.htm> (summarizing cases filed under NAFTA involving the United States, Mexico, and Canada); Ethyl Corp. v. Canada, Award on Jurisdiction, 38 I.L.M. 708 (NAFTA Ch. 11 Arb. Trib. 1998) (challenging ban on MMT); Sunbelt Water v. Canada, 38 I.L.M. 698 (NAFTA Ch. 11 Arb. Trib. 1998) (discussing water protection legislation); Chemtura Corp. v. Canada (NAFTA Ch. 11 Arb. Trib. 2001) (discussing ban on pesticide lindane); Albert Connolly v. Canada, Notice of Intent to Submit a Claim to Arbitration (NAFTA Ch. 11 Arb. Trib. 2004) (discussing order under natural heritage protection program); Metalclad Corp. v. Mexico, Award, ICSID Case No. ARB(AF)/97/1 (Aug. 30, 2000) (discussing failure to grant operating permit pursuant to waste management regulations, designation of site as ecological buffer zone); Glamis Gold v. United States, Award (NAFTA Ch. 11 Arb. Trib. 2003) (relating to preservation of Indian sacred sites in a mining operation); Methanex v. United States (NAFTA Ch. 11 Arb. Trib. Aug. 2005) (challenging California ban on MTBE); Técnicas Medioambientales Tecmed, S.A. v. Mexico, Award, ICSID Case No. ARB (AF)/00/2 (May 29, 2003) (challenging the revocation of a permit for a toxic waste facility). Dow Chemical recently announced the application for NAFTA arbitration to challenge a Canadian pesticide ban. Also in progress is Baird v. United States, Notice of Intent to Submit a Claim to Arbitration (NAFTA Ch. 11 Arb. Trib. 2002) in which an investor owning a patent in the U.S. for the disposal of toxic chemicals alleges that this "investment" has been expropriated by the Nuclear Waste Policy Act of 1995, 1997, and 1999.

<sup>232</sup> See Catherine Yannaca-Small, "Indirect Expropriations" and the "Right to Regulate" in *International Investment Law* (OECD Working Paper No. 2004/4, 2004) (discussing indirect expropriation in international investment law).

his possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law.

The proceeding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.<sup>233</sup>

The Commentary to the American Restatement of the Law of Foreign Relations similarly provides in this context

A State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of States, if it is not discriminatory. . . .<sup>234</sup>

In practice, however, in expropriation cases investment tribunals have often applied domestic U.S. regulatory takings doctrine<sup>235</sup> in favor of investors, disregarding whether the regulations were a nondiscriminatory exercise of State police powers in their findings of breach or in their decision on the amount of the award.

Thus the Tribunal in *Compania del Desarrollo de Santa Elena SA v. Costa Rica* Award of 17 February 2000 concluded:

Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are in this respect, similar to any other expropriatory measures that a State may take in order to implement its policies: where property is expropriated, even for environmental purposes,

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<sup>233</sup> Convention for the Protection of Human Rights and Fundamental Freedoms, Protocol I, art. 1, Nov. 4, 1950, 213 U.N.T.S. 222, available at <http://www.conventions.coe.int/treaty/EN/Treaties/html/005.htm>.

<sup>234</sup> RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS OF THE UNITED STATES § 712(1), cmt. G (1987).

<sup>235</sup> For an exposition of the U.S. takings doctrine, see *Penn Cent. Transp. Co. v. New York*, 438 U.S. 104 (1978) (examining the constitutionality of appellees' actions via the Taking Clause).

whether domestic or international, the State's obligation to pay compensation remains.<sup>236</sup>

This was cited with approval by the Tribunal in the Tecmed case based on the Spanish-Mexican BIT.<sup>237</sup> In a NAFTA claim, the Metalclad Tribunal refused to consider the motivation for a local government's issuance of an ecological decree and denial of a permit for the operation of a waste management facility when it found Mexico had expropriated the investment based on a public service concession contract.

[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the host State.<sup>238</sup>

As Philippe Sands has pointed out, these results at odds with domestic and international environmental law stem from the current fragmented State of international law overall.<sup>239</sup> National and international environmental laws have not been integrated with international economic laws while investment tribunals have mainly adopted a hierarchy preferring international economic law.<sup>240</sup> While the international environmental norm of the "Polluter Pays" would favor environmental enforcement, investment tribunals are more likely to find an impermissible

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<sup>236</sup> *Compañía del Desarrollo de Santa Elena SA v. Costa Rica* (Santa Elena), ICSID Case No. ARB/96/1, para. 72 (Feb. 17, 2000).

<sup>237</sup> See *Técnicas Medioambientales Tecmed, S.A. v. Mexico*, Award, ICSID Case No. ARB (AF)/00/2, para. 121 (May 29, 2003) (finding "no principle stating that regulatory administrative actions are per se excluded from the scope of the Agreement").

<sup>238</sup> *Metalclad Corp. v. Mexico*, Award, ICSID Case No. ARB(AF)/97/1, para. 103 (Aug. 30, 2000).

<sup>239</sup> See PHILIPPE SANDS, *PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW*, 1070-71 (Cambridge Univ. Press 2003) (1995) (describing the *Santa Elena* case).

<sup>240</sup> Philippe Sands, *Litigating Environmental Disputes: Courts, Tribunals and the Progressive Development of International Environmental Law*, OECD GLOBAL FORUM ON INTERNATIONAL INVESTMENT (March 27-28, 2008), available at <http://www.oecd.org/dataoecd/45/7/40311090.pdf>.

barrier to trade in environmental regulation. A good example of this is the SD Meyers case, which did in fact allege discriminatory treatment but is nonetheless remarkable for the degree to which trade law drove the outcome of the dispute to override international environmental law. Claimants challenged a Canadian ban on the importation of PCBs and PCB wastes pursuant to Canada's obligations under the 1989 Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal. The investment arbitral tribunal cited WTO dispute panel precedents to hold that Canada's ban was intended to reduce import competition from the United States and therefore violated the National Treatment obligation.<sup>241</sup> The holding amounts to international administrative review of Canada's environmental laws.<sup>242</sup>

Where a State can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade. This corollary is consistent with the language and the case law arising from the WTO family of agreements.<sup>243</sup>

5.1.2. *Expropriation and Non-Discriminatory Regulation under the U.S. Model BIT*

Responding to the objections of NGOS and States, Annex B 4(b) of the U.S. Model BIT clarifies the scope of regulatory takings:

(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safeties, and the environment, do not constitute indirect expropriations.<sup>244</sup>

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<sup>241</sup> S.D. Myers, Inc. v. Canada, First Partial Award (NAFTA Ch. 11 Arb. Trib. 2000) paras. 258-66, available at [http://www.naftaclaims.com/disputes\\_canada\\_sdmyers.htm](http://www.naftaclaims.com/disputes_canada_sdmyers.htm).

<sup>242</sup> See Klafter, *supra* note 226, at 419.

<sup>243</sup> S.D. Meyers, Inc., para. 221.

<sup>244</sup> Model BIT, *supra* note 3, Annex B(4)(b).



*5.2. The Conflict between Investment Agreement Claims and Non-discriminatory Regulation*

In an investment agreement claim, on the other hand, the treaty contains no express similar limitation barring claims based on non-discriminatory regulation for the public purpose. Neither, of course, would the claimant in an investment agreement claim have to show that she was deprived of the use of the whole or a significant portion of the value of the investment as in an expropriation claim. At the same time, as the particular scope of investment agreements triggers sovereign duties for the stewardship of natural resources, the enforcement of the obligations in investment agreement claims under the DRC are even more likely to come into conflict with non-discriminatory environmental policy-making.

The *Azurix* case illustrates how natural resource concessions easily become a flash point for conflicts between investment law and domestic laws for natural resources management.<sup>245</sup> Azurix Corporation, a subsidiary of Enron, acquired a Concession to provide potable water and operate sewage treatment facilities in Buenos Aires. After local water supplies became contaminated with toxic bacteria, the government urged the residents not to drink the water and to minimize exposure, imposing a fine on Azurix for violating the concession agreement. Further, the water authorities issued regulations disallowing Azurix to bill its customers during the water crisis. Azurix, arguing the bacteria contamination was due to the local government's failure to provide agreed upon infrastructure, complained that the billing prohibition amounted to an expropriation and a breach of the duty of fair and equitable treatment under the U.S.-Argentina BIT. Although the tribunal found a breach of contract in favor of the investor, because the investor had not been found to have been deprived in whole or in significant part of the use or reasonably-to-be-expected economic benefit of its investment, it did not find an expropriation had taken place. Finding a breach of the obligation of fair and equitable treatment, the tribunal stressed the legitimate expectations of the investor at the time of entering into the investment as the primary consideration.<sup>246</sup> The tribunal awarded

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<sup>245</sup> *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12 (July 14, 2006).

<sup>246</sup> *Id.* paras. 316–23.

Azurix for U.S. \$165 million of the more than \$600 million it was claiming.<sup>247</sup> Argentina has applied for an annulment.

Kate Miles has pointed out the imminent prospective conflict between global-warming related regulation and international investment law;<sup>248</sup> conflict is especially likely to crop up over investment agreements in the energy sector. A wide array of activities connected to energy production and distribution are likely to be impacted by cap-and-trade, emissions quotas and other techniques for mitigation. Inevitably, investments that produce large amounts of greenhouse gases will face compliance costs. Already, the German government faces a claim under the Energy Charter Treaty by the corporation Vattenfall over Kyoto Protocol related regulations concerning coal-based electricity production.<sup>249</sup>

The point is not that host State governments should be given a blank check to enact environmental and health regulation regardless of its consequences for foreign investors. Instead, I argue the current investment disciplines are sufficient to the task, and having been previously developed in the context of customary international law, offer more certainty in investment dispute resolution.

### 5.3. *The Chilling Effect on Environmental Regulation*

States should be permitted to incorporate advances in science and technology to protect local populations or join in worldwide efforts to combat transnational environmental problems by introducing new environmental regulation. They should be encouraged to discharge their obligations under international environmental agreements. However, investment treaties attaching penalties to environmental regulations make environmental protection legislation and enforcement a risky game, particularly for less developed States. If investment treaty tribunals continue to follow the trends of the *Metalclad*, *Tecmed* and *Santa Elena* tribunals, disregarding the non-discriminatory purpose behind environmental regulations when assessing investment

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<sup>247</sup> *Id.* para. 442.

<sup>248</sup> Kate Miles, *International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World* (Society of International Economic Law, Working Paper No. 27/08, 2008).

<sup>249</sup> *Vattenfall AB, Vattenfall Europe AG v. Germany*, ICSID Case No. ARB/09/6 (2009).

agreement violations, the chilling effect on environmental regulations could be serious.

If the investment agreement contains a stabilization clause, governments may become absolutely fettered in their ability to regulate concession agreements. Even when an investment agreement does not contain a stabilization clause, host States may prefer not to exercise preventative measures that delay the implementation of a project, such as injunctions or suspension of licenses, for fear of legal retaliation based on foregone profits. Because multinationals often have resources for evasion far exceeding the enforcement capacities of host States, environmental protection in developing countries is already severely challenged. As one author puts it, "Besides the continued application of low standards for decades to come, this situation also shifts to the host state the risk of currently unknown social and environmental standards which may be discovered in future and which may be prevented or minimized through regulation."<sup>250</sup>

The norm of predictability and stability for foreign investment in international law is important, but it should not take absolute precedence over the principle that States are the representatives of their people within their territories. Clearly a proper balance needs to be struck in international investment law between preserving legitimate expectations of investors and the needs of countries to regulate for the welfare of their public. The problem is investment treaties such as the Model BIT currently lack the necessary precision for arbitrators to find the balance. We should distinguish the situation when a State acts intentionally and deceptively to manipulate the machinery of government to deprive an investor of his property rights from those generally applied administrative actions that arise from demands for accountability of government and the true functioning of the democratic legislative process. Without providing tribunals with manageable guidelines for their implementation, the investment agreement provisions, too broadly construed, would easily blur such distinctions.

#### *5.4. A Narrow Interpretation of the Provisions for the Breach of an Investment Agreement*

The previous considerations call for an interpretation of the investment agreement provisions that accord with the customary

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<sup>250</sup> Cotula, *supra* note 16, at 11.

international law on the minimum standard treatment for aliens and respect the right of governments to regulate for the protection of the public welfare. The following matrix is a suggested interpretation of the DRC that attempts to reconcile it with international customary law on contracts between aliens and States. In the case that a regulation or measure in violation of the investment agreement is discriminatory, the law of State responsibility is invoked by the breach of investment agreement and international law is applicable to the investment agreement claim. In this situation, a reasonable interpretation based on the total context of the dispute resolution clause would require the tribunal to award the value of the damage sustained to the underlying investment that provides the standing for the investment agreement claim, namely the reliance interest.<sup>251</sup> But where the challenged State action is a non-discriminatory regulation of general application, whether recovery should be awarded depends on whether the regulation falls within the scope of a valid stabilization clause in the investment agreement.

Although a discussion of the validity of stabilization clauses under international law is beyond the scope of this Article, some relevant considerations in determining whether a stabilization clause is valid could be: (1) the length of the period; (2) the degree of restrictions on state autonomy in policy making (whether it stabilizes the legislative framework or the economic equilibrium of the agreement); and (3) whether the stabilization clause has been otherwise legitimized by specific legislative decrees referring to the commitment (validity under domestic law). Finally, even if the investment agreement has a valid stabilization clause, when the breach of the stabilization clause is due to non-discriminatory exercise of police powers, the proper measure of damages would depend on that specified on the face of the investment agreement or in the host State's contracting laws rather than that awarded under the treaty's award clause.

## 6. CONCLUSION

This Article has discussed the origins and implications of the procedural framework for the arbitration of investment

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<sup>251</sup> David Collins, *An Economic Justification for Reliance Damages at ICSID* (2008), available at [http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=david\\_collins](http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=david_collins).

agreements under the 2004 U.S. Model BIT from both legal and policy perspectives. Under the U.S. Model BIT framework for the arbitration of investment agreement claims, a range of government administrative actions within the prerogative of States to regulate for public health and welfare could become forms of compensable liability for host States that are currently not considered to be violations under customary international law. Government measures in the field of environmental enforcement and natural resources management are particularly likely to become sources of liability for host States. The investment agreement provisions of dispute resolution clause, broadly interpreted, open alternative avenues for investors to claim extensive damage awards against the public sector for breaches of obligations in concession contracts that are not contemplated in the public contracting laws of the States. As such, they are likely to chill legislation in the field of environmental protection and hinder the enforcement of existing national, regional and international environmental laws. Accordingly, in this Article I have argued for a narrow construction of the investment agreement claims provisions to reduce the tension with environmental enforcement, and to reconcile the provisions with customary international law and investment arbitration precedents.