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Countering current practice in investment treaty arbitration, the 2004 US Model 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 the arbitration of contract claims, and discuss some of the implications for States who 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 under the investment treaty that are currently not considered to be international wrongdoing under customary international law or in contemporary BIT practice because of the investment agreement arbitration obligation. Given the theoretical problems with the judicial administration of contract claims in treaty arbitration and the potential conflict with States right to regulate, particularly in the field of environmental law, I present a narrow construction of the investment agreement provisions to reconcile them with customary international law and investment arbitration precedents.>

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I. INTRODUCTION

The question of whether an investor may litigate breaches of concession contracts through investment treaty arbitration has generated heated controversy\(^1\) 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.\(^2\) The United States has addressed this question quite concretely in the dispute resolution clause of its latest prototype for its Bilateral Investment Treaties (“BITs”) and Investment Chapters of Free Trade Agreements, the US 2004 Model Bilateral Investment Treaty (“the Model BIT”).\(^3\) Already incorporated in nine investment treaty arrangements negotiated by the US beginning with the Singapore FTA\(^4\) in 2002, the dispute resolution clause of the Model BIT, (“drc”),\(^5\) contains specific procedures for the arbitration of transnational concession contract claims, procedures that stand to challenge the autonomy of national administrative law systems and impose *de facto* constraints on signatory States’ prerogative to regulate for the health, safety and welfare of their citizens under their police powers.

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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 paper 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 resolving arbitration of 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 Article 24 of the drc, in the event an “investment dispute” cannot be reconciled, a claimant may, on its own behalf (a) or on behalf of a company it owns or controls directly (b) may submit a claim

i) that the respondent has breached…(C) an investment agreement; and

ii) that the claimant has incurred loss or damage by reason of, or arising out of, that breach;

As with many modern BITs, the treaty 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.”)\(^6\) Such an award is not appealable by national courts; it is subject at most to internal review by the International Center for Settlement of Investment Disputes (“ICSID”),\(^7\) or it may be


\(^7\)When the parties to the dispute choose the ICSID rules for dispute settlement under the treaty, Article 53 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“the ICSID Convention”) applies limiting all
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") ⁸ the awards of an arbitration tribunal founded under the Model BIT must be enforced by the mandate of the treaty.⁹ A party may also seek enforcement in the national courts under the convention establishing ICSID.¹⁰

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,¹¹ they are apparently the first to specifically require the settlement a claim for a breach of a concession contract with an investor under direct recourse arbitration pursuant to a consent clause. Since concession agreements usually 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

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forms of review to the ICSID Annullment Procedure 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.”

Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the ICSID Convention) 4 ILM 524 entered into force 1966.


¹⁰ Enforcement under the ICSID Convention, which is subject to fewer defenses, is available when the parties choose ICSID Arbitration rules under Article 24.3 of the Model BIT.

¹¹ The Algiers Accord creating the US-Irans Claims Tribunal vested the tribunal with jurisdiction to deal with disputes arising over contracts (Article II, Sec.1). (Declaration of the Government of the Democratic and Popular Republic of Algeria and the 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, January 19, 1981, collectively referred to as the Algiers Accords.) 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.
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.

As treaty tribunals have declined to make awards solely on the basis of the breach of a State contract\textsuperscript{12} to this point,\textsuperscript{13} 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,\textsuperscript{14} 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.\textsuperscript{15} 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

\textsuperscript{12} I take State contract to mean a contract between a State and an alien investor in the general sense.

\textsuperscript{13} The author knows of only one case in which a breach of contract was deemed an independent cause for compensation in an investment treaty arbitration: \textit{Eureko B.V. v. Republic of Poland}, -Partial Award and Dissenting Opinion, 19 August 2005. para 262 (available at \url{http://ita.law.uvic.ca/documents/Eureko_PartialAwardandDissentingOpinion.pdf}). 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 (the Agreement between the Kingdom of the Netherlands and the Republic of Poland on the Encouragement and Reciprocal Protection of Investments.) However, no decision on the measure of damages was rendered and annulment has been applied for.

\textsuperscript{14} See Part IVB below

\textsuperscript{15} Id.
agreement contains a stabilization clause, host States could face much tighter constraints in policy and be more frequently obliged to compensate for regulation.\textsuperscript{16} Faced with such 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 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 public contract law. Such uncertainties could ultimately undermine predictability and stability that is the goal of US 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 Part II I sketch briefly the well-
documented 20th century evolution of various theories internationalization17 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 Part III I review the holdings of recent influential BIT arbitrations on the treatment of contract claims in treaty tribunals. Part IV 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 of contract claims discussed in the investment treaty awards in Part III. Finally, in Part IV, 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. Part V concludes.

II. THEORIES ON THE INTERNATIONALIZATION OF STATE CONTRACTS

It is common in undertaking a foreign investment project for foreign investors 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 some host State promises may only negligibly influence a foreigner’s decision to invest, more acute situations arise in long-term projects where public services are provided or

17 Sornarajah, supra at note 2.
natural resources extracted in close cooperation with the host State. It is 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 bargain¹⁸: 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 usually it will prevail in designating the law of the host State to govern the contract and courts or administrative tribunals of the host State for the resolution of disputes. From the investor’s point of view, 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 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 WWII, 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. Accordingly, since the 1960s legal practitioners and academics from the capital-exporting countries have developed and propounded an alternative body of transnational law to apply to concession agreements to displace or supplement national law, drawing inspiration, in many cases, from previous 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, in which arbitrators grappled with the 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. This competing norm of permanent sovereign rights over natural resources meanwhile over time became assimilated in the investment laws

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19 Sornorajah believes the outlawing of the use of force in the UN Charter was an important reason that capital exporting countries needed “the construction of a distinct legal system which would give security to existing and future concession agreements.” Sornorajah, id note 2 p.406.

20 Internationalization has been given definitions in addition to the one I use. Some writers refer to “transnationalization,” “delocalization” or “denationalization.” Maniruzzuman defines internationalization as follows: “The theory 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.” A. Maniruzzuman, State Contracts in Contemporary International Law: Monist versus Dualist Controversies. EUROPEAN JOURNAL OF INTERNATIONAL LAW, Volume 12, Number 2, April 2001 , pp. 309-328(20)


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 and transparency in governance.²³

**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 choosing international arbitration in the forum selection clause, the host State will be bound under international law to the individual obligations in the agreement.²⁴ The most common version of this theory assumes the existence of universal private international law outside of either municipal law or public international law based on international commercial practice 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 sund servanda*²⁵ as well as the requirement to observe good faith²⁶ in contractual relationships and the doctrine of acquired rights.²⁷ Although the concept of a universal private law based on international commercial practices, or *lex mercatoria*, has found almost universal acceptance in international sales and finance contracting between private parties and to a lesser extent in procurement

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²³ “State contracts and the conflict of doctrines associated with them may be seen as a core purpose of making investment treaties,” UNCTAD, “State Contracts,” UNCTAD/ITE/ITT/2004/11, p. 6
²⁴ Jennings, Robert, *State Contracts in International Law*, 37 BJIL 157, 1961 p.156
The good faith principle has been codified in Art. 1.7 of the UNIDROIT Principles of International Commercial Contracts, International Institute for the Unification of Private Law (Unidroit), Rome, Italy. 1994. Available at www.unidroit.org/english/principles/contracts/main.htm
²⁷ The Award in the ARAMCO case contains one of the clearest expressions of acquired rights doctrine applied to an oil concession. ARAMCO *supra*. note 21 at 117
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 a standard of compensation for breach less than that for commercial contracts as a form of administrative contract.  

An alternative justification for the belief that choice of law and arbitration clauses could achieve internationalization was a theory characterizing modern concession contracts as public international law agreements. A minority of scholars argued that by virtue of the unique character of agreements for the extraction of natural resources under EDAs or “economic development agreements” or “investment agreements,” a breach of such an agreement would invoke State responsibility per se. In the TOPCO arbitration, the sole arbitrator Dupuy followed this theory to conclude that a breach of an oil concession contract was internationally wrongful, even though the governing law clause of the concession agreement at issue referred 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.

_Umbrella Clauses_

As an alternative to contractual devices, capital exporting countries sought to protect concession

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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 US\(^\text{33}\) to replace the Treaties of Friendship, Commerce and Navigation. Reproduced in various forms, umbrella clauses proliferated to such a degree that UNCITRAL has estimated that over 40% of the more than 2500 BITs in existence contain umbrella clauses.\(^\text{34}\) The first umbrella clause appeared in the 1957 Abs-Shawcross Draft Convention on Foreign Investment,\(^\text{35}\) an early attempt to create a permanent international investment protection tribunal through a multilateral investment treaty. That clause, Article II, read: “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.”

The idea derived from a 1954 draft settlement agreement for the Anglo-Iranian Oil Company’s claims regarding Iran’s oil nationalization program.\(^\text{36}\) 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 the most 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 tribunal with subject matter

\(^{33}\) An umbrella clause appeared in the US Model BIT Treaties of 1984 and 1992 and was used in negotiating treaties until NAFTA dropped the clause in 1994, along with any reference to contract claims.


jurisdiction for the contract claim. One investment treaty tribunal went farther to state: “An umbrella clause is usually seen as transforming municipal law obligations into obligations directly cognizable in international law.”

Those who argue that umbrella clauses in investment treaties operate to attach State responsibility to a State contract breach and those who argue internationalization could be achieved through a choice of law clause tended to defend their positions on similar grounds. They contended 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. Even if a State’s conduct did not rise to expropriation, it was desirable and equitable to protect the investor’s legitimate-investment-backed expectations. Although less plausible today, 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.

Stabilization Clauses in Investment Agreements

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37 Eureko v. Poland, supra note 3, para 250
38 FA Mann, British Treaties for the Promotion and Protection of Investments, 52 BRIT. Y.B. INT’L L. 241, 245 (1981)). p. 246
39 This was a central concern in the Sapphire arbitration. Sapphire supra note 21. 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 and Co Case, PCIJ, Series C, No. 78 (1929) and Certain Norwegian Loans , ICJ Rep. 9 (1957). In many if not most of the legal systems today, public contracts contain a termination at will clause in favor of the government party. Derek Bowett discusses “termination at convenience clauses” in the United States and the UK in State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach 1988 59 BYIL 49-77 p. 56-58
40 Aminoil v. Kuwait. ILR 66,518The 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 jurisprudence. Dolzer and Schreuer consider the investor’s legitimate expectations are based on the host State legal framework for investment at the time of investment plus any explicit assurances on which the investor relied Rudolf Dolzer and Christopher Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, p.134 (Oxford, 2008)
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, 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.

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, stabilization clauses are employed by investors to prevent

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42 For examples of the many forms of contemporary petroleum concession agreements could take, see the website of the Independent Petroleum Association of America, www.IIPA.org. See also Chapter 3 of Bishop, Crawford and Reisman, FOREIGN INVESTMENT DISPUTES: CASES, MATERIALS AND COMMENTARY, (Kluwer, 2005.)
43 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 place in the late 20th century, especially with the increase in privatization projects in the post-Soviet States. Dolzer and Schreuer, supra. n35 p.73
44 id n. 35 p. 75
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\footnote{See for example, Article 17 of the 1948 Concession Agreement between Aminoil and the Shaikh of Kuwait as related in Hunter, Martin and Anthony Sinclair in 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, p. 347.} 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,\footnote{The arbitrator in the TOPCO arbitration found nationalization to be a violation of the concession’s stabilization clause. TOPCO, supra note 21 at para 73 -91. The arbitrators in BP Libya, Liamco-Libya, and Aminoil did not find stabilization clauses could not render nationalization illegal. See the discussion in Higgins, Rosalyn, “The Taking of Property by a State” Recueil de Cours, 1982. pp 301-304} 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.\footnote{Thomas Waelde and George Nnd, Stabilising International Investment Commitments: International Law Versus Contract Interpretation, Centre for Petroleum and Mineral Law and Policy Internet Journal, Vm 1-9 available at http://www.dundee.ac.uk/cepmlp/journal/} 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 equilibrium clause, which requires compensation in case of a change in expected profits from a project.\footnote{For a discussion of the implications of stabilization clauses for the exercise of social and environmental regulation, see Cotula, supra, note 16.}

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, 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.

The above contractual devices for internationalizing contracts gained credibility and currency with the growing acceptance of the theory of party autonomy in judicial systems requiring judicial acquiescence to a forum selection clauses as well as the expansion in institutional means for the resolution of international contract disputes throughout the 20th century. With the widespread ratification of the New York Convention, it became much easier to enforce foreign and commercial arbitral awards than foreign judgments. The establishment of ICSID in 1965 in particular permitted parties in a dispute over a concession agreement to request ICSID arbitration by presenting an agreement to arbitrate at ICSID in writing. Along with the ad hoc petroleum arbitrations, the progressive development of the law related to transnational State contracts was carried out on several fronts through the arbitrations of

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49 This was argued by the UK government in the Anglo-Iranian Oil Case, PCIJ Pleadings, pp. 86-93. Sornorajah summarizes this theory as, “The 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.” Sornorajah supra note 2, p. 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. Ian Brownlee, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, p. 554 (Fifth Edition Oxford University Press, 1998).

50 Aramco and Sapphire arbitrations, supra, note 21 TOPCO, supra note 21, para 45. See below p. 53 on the conclusions of the El Paso (infra, note 117) and PAE (infra, note 88) tribunals. For an overview of the holdings of major ad hoc petroleum arbitrations concerning stabilization clauses, see Part III of Marguerita Coal., Stabilization Clauses in International Petroleum Transactions, Denver Journal of International Law and Policy, March 2002

51 In the United States the implementing legislation to the New York Convention under the Federal Arbitration Act, 9USC Sec. 3 and 4, 9USC Sec 206 and Sec. 208.
private tribunals of the ICC, public mixed claims tribunals\textsuperscript{52} and in ICSID tribunals\textsuperscript{53}.

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. A body of BIT arbitration cases addressing claims arising from concession contract disputes\textsuperscript{54} thus joined the earlier renderings 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 --and only 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.\textsuperscript{55}


\textsuperscript{54} Catriona Paterson, \textit{Investor-to-State Dispute Settlement in Infrastructure Projects}, (OECD Working Papers on International Investment Number 2006/2, March 2006.) The study canvasses 28 arbitrations under BITs in telecommunications, transportation, water and sanitation and the energy sector.

\textsuperscript{55} Consortium R.F.C.C. v. Kingdom of Morocco, ICSID Case No. ARB/00/6, Award 22 December 2003; PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Elektrik Uretim ve Ticaret Limited Sirketi v. Turkey, ICSID Case No. ARB/02/5, -Award, 19 January 2007; Aguas Del Tunari v. Republic of Bolivia, ICSID Case No. ARB/02/3 Decision on
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. Most of the discussion is devoted to whether the investment treaty tribunal has jurisdiction for contract claims based on the scope of the consent to arbitrate in the relevant treaty as evidenced by an umbrella clause. 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.

III. CONTRACT CLAIMS IN BIT TRIBUNALS

General Principles

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.\textsuperscript{56} 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 visa viz the host State of investment.\textsuperscript{57} Historically a breach of a contract with an alien alone was not seen by the UK and other major capital exporting countries as justifying diplomatic protection because of adverse political side effects.\textsuperscript{58} 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.\textsuperscript{59} Traditional opinion says 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,\textsuperscript{60} 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.\textsuperscript{61}

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.\textsuperscript{62}

Otherwise, customary international law would also provide a remedy if the State acted in so arbitrary a

\textsuperscript{56} Brownlee, \textit{supra} note 53 p. 551. “Actions are discriminatory if directed against persons of a particular nationality or race; they are arbitrary when they lack a normal public purpose.”

\textsuperscript{57} Mavrommatic Palestine Concession Case (1924)PCIJ Re Series A No2., 12


\textsuperscript{59} Amerasinghe, \textit{supra} note 58 gives 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.

\textsuperscript{60} The Court Stated, “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.” Serbian Loans case 1929 BCIJ, Series A, No. 20, 21, and 41.

\textsuperscript{61} A more moderate view is presented by Derek Bowett, “the 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.” Derek Bowett, \textit{Claims Between States and Private Individuals: the Twilight Zone of International Law}, Catholic University Law Review Summer, 1986, p.4.

\textsuperscript{61} Brownlee, \textit{supra} note 53 p. 553.
manner as to commit a “denial of justice.” ⁶³ In sum, if a host State incidentally breaches a contract with an investor for a normal public purpose 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 is not responsible for international wrongdoing.

*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 with both public international law and private law elements, rights arising from the breach of the BIT’s standards for treatment toward the investor or investments vest directly with the investor and not with the investor’s State.⁶⁴ 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 law⁶⁵ created by BITs is not confined to the customary international law on State responsibility in relation to a breach of contract.⁶⁶

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 concerning an irreconcilable “investment dispute.”

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⁶³ Paulson, Jan *DENIAL OF JUSTICE IN INTERNATIONAL LAW*, Cambridge University Press, 2005 American Law Institute, *RESTATEMENT OF THE LAW THIRD, THE FOREIGN RELATIONS OF THE UNITED STATES, Volume 1, 1987, Section 712*. Economic Injury to Nationals of Other States. A state is responsible for… (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.


⁶⁵ BYIL (2003). pp 151-289

⁶⁶ Id. p. 159 “...the contracting States to investment treaties have opted out of the inter-State secondary rules of international responsibility in relation to a limited group of wrongs causing damage to a particular sphere of private interests.”
When the subject matter jurisdiction clause of an investment treaty dispute resolution section is met by the dispute and any procedural conditions agreed to by the States have been satisfied, the investment treaty expresses an offer of consent 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”)\(^67\). However, it is also well accepted that the consent under a BIT is more than merely an element of a treaty: James Crawford has for instance has characterized the consent clause as contract governed by international law that springs into effect when the investor perfects the consent by requesting arbitration rather than a treaty.\(^68\)

**Disputes with Domestic Governmental Authorities**

Many of the cases dealing with contract issues 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 the 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 that entity will be attributed to the State for purposes of determining State responsibility.\(^69\) Thus, normally the fact that the counterparty to the contract in dispute is

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\(^{64}\) Article 31 States “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…” Article 32 discusses supplementary means of interpretation. Although this treaty approach to interpretation of the consent to arbitrate reflects the reasoning of the majority of Tribunals.


\(^{66}\) International Law Commission, “Articles on Responsibility of States for International Wrongful Acts and Commentaries,”
a local government or a government-owned company would not by itself automatically bar a treaty claim against a national government, although it bars the contract claim against the national government.70

**Investment Treaty Arbitral Jurisprudence on Contract Claims**

**Treaty claims versus contract claims: Vivendi**

The most important case to date setting out the principal issues in the treatment of contract claims in BIT tribunals is the Vivendi Annulment.71 In sharp contrast to the oil arbitrations of the earlier era that flexibly considered international law and domestic law in matters of contract, the Ad Hoc Committee in the Vivendi Annulment sharply 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 Province of Tucuman.72 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.73 The

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70 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 to ICSID under Article 25(3) of the ICSID Convention.


72 Compañía de Aguas del Aconquija S.A. and Companie General de Eaux v. Argentine Republic, ICSID Case No. ARB/97/3. Award, 21 November 2000 ( “Vivendi I”)

73 Agreement between the Government of the Argentine Republic and the Government of the Republic of France for Reciprocal
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 Tucuman. 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.\(^7^4\).

The Vivendi Tribunal decided to separate the allegations of the claimant into claims against the
national authorities (the federal claims) and the provincial authorities (the Tucuman claims). With respect
to the federal claims, it found Argentina had not breached the treaty since the specific allegations concerned
the acts of Tucuman and Argentina was under no duty to prevent or enjoin the actions of Tucuman under the
treaty. With respect to the local claims, it stated that the facts 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
Tucuman authorities had been assigned by the forum selection clause of the Concession Contract to the
administrative courts of Tucuman, the claimants had a duty to first pursue their rights with respect to such
claims in the contractually agreed upon forum.\(^7^5\)

In this case, however, the obligation to resort to the local courts is compelled by the express terms of

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Protection and Promotion of Investments of 3 July 1991

\(^7^4\) *Vivendi I* *supra* note 79, paras 40 -55.

\(^7^5\) *Id, para 181*
Article 16.4 of the (Concession Contract) and the impossibility, on the facts of the instant case, of separating potential breach of contract claims from BIT violations without interpreting and applying the Concession Contract, a task that the contract assigns expressly to the courts.76

In its 2002 Decision on Annulment, although the Annulment Committee (the “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.77 Emphasizing the two autonomous systems of municipal and international law, the Committee found 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…Whether there has been a breach of the treaty and whether there has been a breach of contract are different questions. Each of these claims will be determine by reference to its own proper or applicable law—in case of the BIT, by international law; in case of the Concession Contract, by the proper law of the contract, in other words, the law of Tucuman”78

In the Committee’s view, it is not open to an ICSID Tribunal having jurisdiction under a BIT in

76 Id, para 181
40 Vivendi Annulment, supra note 78, para 111

78 Id, para 96
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 require 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. A State cannot rely
on an exclusive jurisdiction clause in a contract to avoid the characterization of its conduct as
internationally unlawful under a treaty. 79

Referring to the Woodruff Case, 80 the Committee reiterated the view that the legal effect of a forum
selection clause should depend on the whether the fundamental nature of the dispute was contractual or
treaty-based. “Where 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 contract81... 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.82”

After the Vivendi Annulment, BIT Tribunals began to face more frequently the issue of jurisdiction
over independent contractual claims squarely. Prospective contract claimants attempted to advanced

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79 Id, para 102 This is in reference to Article 27 of the Vienna Convention., supra note 74
(1903)
81 Vivendi Annulment, supra note 78, para 98
82 Id, para 101
independent contract claims 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. A few cases have considered the question of whether a Most Favored Nation (“MFN”) clause can entitle an investor to claim the benefit of arbitration of his or her contract claim though a treaty with another country. In practice, only a few tribunals have held in favor of independent contract claims jurisdiction, and to the extent investment treaty tribunals have considered jurisdiction for disputes arising out of contract claims, they have imposed various qualifications. The overwhelming majority have held they will not have jurisdiction for a contract claim between a State and an alien unless the government conduct at the same time breached a substantive obligation under the treaty.

**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

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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.

*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.” Under the PSI agreement, after evaluations were made, SGS was to submit monthly reports on the value and origin of the goods and the customs revenues generated. 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 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.

The PSI entered into force in January 1 1995 and the Pakistani government gave notice of termination in January 1997. During 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 by asking the Supreme Court of Pakistan to refer the decision to an arbitrator in accordance with the Arbitration, Act, to which SGS responded with counterclaims of “wrongful repudiation of contract.”

While these claims were pending, SGS initiated ICSID arbitration against the government of
Pakistan for violation of five articles the Swiss Pakistani BIT, including\(^{86}\) 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)).\(^{87}\) 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,\(^{88}\) 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 Centre and not to an alternative forum” under the principle of \textit{pacta sunt servanda} and party autonomy.\(^{89}\) 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,

\(^{86}\) Agreement between the Swiss Confederation and the Islamic Republic of Pakistan on the Promotion and Reciprocal Protection of Investments, date in force?

\(^{87}\) SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, \textit{ICSID Case No. ARB/01/13} (“SGS Pakistan”) Decision on Jurisdiction, August 6, 2003. The complaint set out 8 heads of compensation, including payment of outstanding invoices of US$8,368,430.49, compensation for lost profits of US$31,500,000 and compensation for “lost opportunities” of US$70,000,000 which were substantially the same as those in the Pakistan arbitration.

\(^{88}\) Id. para 43, 44

\(^{89}\) Id. para 48-50
therefore all claims should be submitted to the Pakistani arbitration.\textsuperscript{90}

*Holding on contract claims*

Addressing the issue of whether it could adjudicate solely contract claims, the Tribunal’s decision began with a confirmation 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.”\textsuperscript{91} 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.”\textsuperscript{92}

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.\textsuperscript{93}

*Holding on the umbrella clause*

Article 11 of the Swiss Pakistani 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.”

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

\textsuperscript{90} Id, para 70
\textsuperscript{91} Id, para 161
\textsuperscript{92} Id, para 161
\textsuperscript{93} Id, para 162
considering the widely accepted principle with which we started, namely, that under general international law, a 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 11.94

Specifically, among other consequences, if Article 11 internationalized every contract claim, “there would 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.”95

The Tribunal considered the umbrella clause was 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.”96 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

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94 Id, para 167
95 Id, para 168
96 Id, para 171
claims grounded solely in contract 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.”

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 affiliated company under the Swiss Philippines BIT. 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.” 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 was inspected and invoiced at US $680 million but a
government inquiry found that only about US$540 million was paid.

SGS commenced ICSID arbitration based on breaches of clauses of the Swiss Philippines BIT

97 Id, para 165

98 SGS Philippines, supra note 91.
guaranteeing full protection and security (Article IV); fair and equitable treatment, Article IV (2); effective and adequate compensation in cases of expropriation (Article IV); and observation of obligations, (the umbrella clause) Article X (2).\textsuperscript{99}

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.\textsuperscript{100} “Article 12 represents a real and genuine agreement, being the product of an arms-length bargain of the parties that resulted from a competitive tender and bidding process.”\textsuperscript{101} It further maintained that the Swiss-Philippines BIT had no application to purely contractual disputes and denied the BIT was intended to override previous obligations with respect to “specific investments.”

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. II-VI. What SGS is effectively saying is that this substantial body of international law practice is now to be rendered effectively \textit{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.\textsuperscript{102}”

\textit{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

\textsuperscript{99} Id, para 44
\textsuperscript{100} Id, para 51
\textsuperscript{101} Id, para 52
\textsuperscript{102} Id, para 76.
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.\textsuperscript{103} 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.\textsuperscript{104}

The basic obligation on the State in this case is the obligation to pay what 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 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.\textsuperscript{105}

\textit{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” was intended to include contract claims, \textit{inter alia} because among the \textit{fora} only the treaty Tribunal was competent to consider both treaty and contract claims. Therefore efficiency counseled treating the claims in a single

\textsuperscript{103} Id, para 115-116

\textsuperscript{104} Id, para 126

\textsuperscript{105} Id., para 127.
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.” The Tribunal decided that the significance of the exclusive forum selection clause went to the question of admissibility, instead.

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 Tribunals 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 able to approbate and reprobate in respect of the same contract.

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

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106 Id, para 132  
107 Id, para 134  
108 Id, para 154 - 155
agreement or submission to the Philippine court, that its decision would be premature and ordered a stay for
both types of claims.\textsuperscript{109}

\textit{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.\textsuperscript{110} 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 US$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. \textsuperscript{111}

Concerning the “Chinese fraud allegation,” it stated:

\textsuperscript{109} Id. para 175.
\textsuperscript{110} SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, \textit{ICSID Case No. ARB/02/6}, Order of the Tribunal on Further Proceedings, 17 December 2007, para 25
\textsuperscript{111} Id, para 25
… 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\textsuperscript{112}.

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

The SGS Pakistan restrictive view of the legal effect of umbrella clauses has been endorsed by such Tribunals as those in Salini v Jordan\textsuperscript{113}, Joy Mining, Impregilio, El Paso\textsuperscript{114} and PAE.\textsuperscript{115} The Tribunals in Noble Ventures, Eureko Mining, MTD equity, LG & E, Siemens, Duke Energy and Sempra\textsuperscript{116} took a more expansive view in line with SGS Philippines. Among these, only the tribunals in Noble Ventures\textsuperscript{117} and Eureko Mining\textsuperscript{118} accepted that a breach of a contractual obligation was identical to a treaty breach. Many have required an extra legislative or executive commitment in addition to those made in the contract itself to trigger the operation of the umbrella clause,\textsuperscript{119} and some have applied the umbrella clause only to the

\begin{footnotesize}
\begin{enumerate}
\item Id, para 26
\item El Paso Energy International Company v. The Argentine Republic, \textit{ICSID Case No. ARB/03/15}. -Decision on Jurisdiction, 27 April 2006
\item supra, note 92
\item supra note 92
\item Noble Ventures, \textit{supra}, note 40
\item Eureko Mining, \textit{supra}, note 13
\item Duke Energy, \textit{supra} note 92
\item para 322.
\end{enumerate}
\end{footnotesize}
breach of the legislative commitment itself and not to a specific commitment in a contract. One tribunal held that an umbrella clause breach occurred by a violation of a power purchase agreement because of assurances provided by existing the statutory framework for energy regulation.  

**The Test of Puissance 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 an 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.

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120 SempraAward, *supra* note 92 para 305-322
122 Impreglio, *supra* note 92, para 85. 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. Islamic Republic of Pakistan, *ICSID Case No. ARB/03/29* Decision on Jurisdiction, 14 November 2005, para 180. (“Bayindir”)
Joy Mining: Denying Protection for Commercial Claims

Several tribunals have attempted to prevent contract claims from being adjudicated in treaty tribunals on the grounds that to allow it would be “destructive” of the two legal orders, municipal and international. The Joy Mining\textsuperscript{123} Tribunal considered a dispute arising out of a supply contract for longwall mining systems in a phosphate mine (“the Contract”) between the company and the General Organization for Industrial and Mining Projects of the Arab Republic of Egypt (“IMC”). 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 Pounds 9,605,228, about two-thirds of the total Contract price.

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. 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. In particular it claimed that the its funds (those to be obtained by the letters of guarantee) had been

\textsuperscript{123} Joy Mining, supra note 92
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. 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.

The Tribunal did not accept the characterization of the Contract or the guarantees as investments for the purposes of the treaty. Neither did it think it would be possible to expropriate “a contingent liability” Thus it found the entire dispute to be an “ordinary commercial dispute”. In the absence of treaty claims, it held 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.124

A basic general distinction can be made between commercial aspects of a dispute and the other aspect involving the existence of some forms of State interference with the operation of the contract involved125…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

124 Id, Para 38
125 Id, Para 72
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.¹²⁶

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 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.¹²⁷

 Protection for investment agreements: El Paso and PAE

For a few tribunals, however, entering into a contract 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 in particular drew the distinction between a contractual legal relationship between the State and the

¹²⁶ Id, Para 79
¹²⁷ Id, Para 81
investor that arises due to the State acting in a commercial capacity (*jus imperii*) and one that arises due to the State acting in a sovereign capacity (*jus gestionis*).\(^{128}\) Apparently on this basis, the El Paso and the PAE Tribunals declared all contracts to constitute either commercial contracts or investment agreements.\(^{129}\)

Further, only investment agreement breaches could be converted to treaty breaches by the umbrella clause, in other words: “only 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.”\(^{130}\)

Offering little other support for this theory, the Tribunal arrived at this conclusion in the particular case by interpreting the umbrella clause Article II of the Argentine US BIT ( “the 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 into with regard to investments”. The dispute resolution clause Article VII(1) States:

> An 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.

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

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\(^{129}\) Id, Para 77
\(^{130}\) Id, Para 80  See also CMS Award, *supra* note 92, paras 299-300.
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.”

In 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(sic), 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 considered as treaty claims the breaches of an investment agreement between Argentina and a national or company of the United States.

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 addressed the question of whether a contract claim should be

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131 Id, Para 81

132 Id, Para 84. The Tribunal positively referenced the 2004 US Model BIT in coming to this conclusion, but didn’t explain why.

considered an investment dispute under the Italy Morocco BIT referring to: “All 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.”\textsuperscript{134} 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: “The reference to expropriation and nationalization 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.”\textsuperscript{135}

The Vivendi Annulment Committee, considering the dispute resolution clause of the US Argentina 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.\textsuperscript{136}

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.”\textsuperscript{137} The Tribunal in SGS Philippines in contrast agreed with the claimant that the Tribunal contract claims should also be included in

\textsuperscript{134} Italy Morocco BIT name  
\textsuperscript{135} Salini v. Morocco, supra note 140 Para 132  
\textsuperscript{136} Vivendi Annulment supra note 78, Para 55  
\textsuperscript{137} Id, para 161
the phrase “disputes with respect to investments between a Contracting Party and an investor of the other Contracting Party.” The Tribunals in Fedax, Impregilo, Tokio Tokelas v. Ukraine, and Parkerings came to similar conclusions.

**MFN and contract claims jurisdiction: Impregilo, Salini v. Jordan**

While the application of MFN to arbitration procedures under BITs in general continues to be highly controversial, two tribunals have rendered decisions specifically on whether the investment tribunal had jurisdiction for 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 jurisdictional benefit of the umbrella clause in another treaty through the Most Favored Nation clause Article 3 of the Italy Pakistan BIT to attain jurisdiction for a contract. After determining WAPDA to be separate from the government of Pakistan under Pakistani law, the Tribunal Stated, “...given that the Contracts were concluded by Impreglio with WAPDA, and not with

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138 SGS Philippines, supra note 91, Para 134
139 Fedax, supra note 88

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.”

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). 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 US$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-USA BIT and Article 6 of the Jordan-United Kingdom BIT giving US investors in Jordan “the right to submit investment disputes with the host State to ICSID

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142 Impreglio, supra note 92, Para 223
143 Jordan Italy BIT
regardless of any clause in the investment agreement providing for a different dispute settlement mechanism” made available to investors of USA and UK “a dispute resolution clause which is more favorable” than that of the Jordan-Italy BIT. Therefore, it argued the MFN clause Article 3 of the Jordan Italy BIT allowed the claimant to submit the dispute to ICSID arbitration. Article 3 read: “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.”

The Tribunal endorsed the position of Jordan that the Contracts were investments agreements within the meaning of the Jordan-Italy BIT, Article 9(2) of 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.144

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. Some tribunals have approached the issue from another perspective: has the investor waived treaty arbitration under international law, either expressly or by 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

144 Salini v. Jordan, supra note 120, Para 118.
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 investors? To the extent that tribunals believe such a waiver possible, most require an explicit expression of waiver of ICSID arbitration to be effective.

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 above, this may be equally viewed as an expression of the principle of party autonomy or pact sund 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 latter 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:

Article 16.4 of the Concession Contract does not divest this Tribunal of jurisdiction to hear this

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145 See Section IV of Ole Spierman, Individual Rights, State Interest and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties “The question is whether the interest of the home State are sufficient to oppose party autonomy and deny the investor the power to waive international arbitration.” “The 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.” 20 Arbitration International 179-211 (2004)

146 See also Salini v. Morocco supra note 140, Azurix supra note 61, AES supra note 92 Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3 Decision on Jurisdiction, 14 January 2004., CME supra note 92 Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic ICSID Case No. ARB/03/19 Decision on Jurisdiction, 3 August 2006 and CMS Award, supra note 92
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.148

In the 1998 Lanco arbitration,149 the Tribunal rejected argument that investors had waived treaty arbitration by entering into forum-selection clauses assigning the dispute to administrative courts of the province. 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,150 it denied that such a forum-selection clause could express consent overriding ICSID jurisdiction, as administrative jurisdiction was not selectable under Argentine law.151 Other tribunals such as the one in Salini v. Morrocco have adopted Lanco’s reasoning to deny effect to exclusive forum selection clauses.152

Express waiver: Azurix and Aguas Del Tunari

148 Vivendi I, supra note 79.
149 Lanco International v. the Argentine Republic. ICSID Case ARB 97/6 Preliminary Decision on the Jurisdiction of the Tribunal, December, 1998.
150 Id, para 20
151 Id, para 19 An opposite view on exclusive forum selection clauses is provided in Crawford, supra note 75, p. 13 Maintaining that a treaty tribunal may not adjudicate a claim over an exclusive foreign selection clause in a contract, Crawford states “Pacta sund servanda is not a one-way street.”
152 Salini v. Morrocco, supra note 140, para 27
The Vivendi Annulment Committee opined that if a forum selection clause in a contract did purport to exclude the jurisdiction of an international tribunal arising under the BIT, whether a contractual claim or a treaty claim, a clear indication of intent to exclude jurisdiction would be required.\textsuperscript{153} The Azurix case\textsuperscript{154} 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 US-Argentina BIT but no contract claims.

Argentina objected to jurisdiction on the grounds that all of the contractual documentation relating to the investment provided express waivers of “any other forum, jurisdiction or immunity that may correspond” “for all disputes arising out of the Bidding” 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.\textsuperscript{155} 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.\textsuperscript{156}

Azurix argued, *inter alia*, that the two claims were based on different sources of right, and that if it had made a waiver, it was only concerning contractual rights, not BIT claims.\textsuperscript{157} 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

\textsuperscript{153} Vivendi I, supra note 79, para 77  
\textsuperscript{154} Azurix, supra note 61.  
\textsuperscript{155} Id, para 26  
\textsuperscript{156} Id, para 26  
\textsuperscript{157} Id, para 32.
national courts, previously agreed upon forum or ICSID arbitration.\footnote{Id, para 35}

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 exclusivity of a forum implies by definition the
renunciation of any other \textit{fora} whether or not explicitly stated in the clause.”\footnote{Id, Para 80} The important point was
that “The claims or causes of action before this Tribunal are different in nature from any claims which ABA
could bring before the courts of the city of La Plata under the contract documents.”\footnote{Id, Para 81}

The Aguas del Tunari Tribunal\footnote{Aguas, \textit{supra} note 61} distinguished express waivers and exclusive forum selection
clauses in its analysis, on the other hand.\footnote{Id., Para 118} At the outset, 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 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 the
exclusive forum selection clause.”\footnote{Id, Para 119} 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.\footnote{The Tribunal cited Article 26 of the ICSID convention as proof that this was the prevailing view at the time of the Washington Convention after Spiermann. Aguas, \textit{supra} note 61. fn 89.} 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 \textit{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

\footnote{Id, para 35}
\footnote{Id, Para 80}
\footnote{Id, Para 81}
\footnote{Aguas, \textit{supra} note 61}
\footnote{Id., Para 118}
\footnote{Id, Para 119}
\footnote{The Tribunal cited Article 26 of the ICSID convention as proof that this was the prevailing view at the time of the Washington Convention after Spiermann. Aguas, \textit{supra} note 61. fn 89.}
with “the same matters and parties and contain conflicting obligations.”\textsuperscript{165} But an exclusive forum selection clause alone would need separate, more conclusive proof of the parties’ intent for the Tribunal to infer a waiver. “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.”\textsuperscript{166}

\textit{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,\textsuperscript{167} 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.\textsuperscript{168} Thus, these tribunals have held prior submission of a contract claim would not cause a treaty claim to be waived.

\textit{Conclusion:}

\textsuperscript{165}Id, para 111

\textsuperscript{166} Id, paras 118-119 See also, Occidental, \textit{supra} note 61 paras 72-73


\textsuperscript{168} Vivendi I, supra note 79, Azurix, supra note 61, paras 88-90. Enron \textit{supra} note 155, CMS Jurisdiction supra note 91, para 8; CME \textit{supra} note 91
From the foregoing we see 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 independent contract claims jurisdiction in terms of traditional public international law and treaty interpretation, imposing a high bar to 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.

The Model BIT attempts to anchor jurisdiction for the 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. As discussed below, these concerns include 1) the need to maintain separation between and finality in the respective spheres of municipal and international law with regard to contract claims, and 2) whether a new claim for breach of contract basically duplicates the relief already provided under the other treaty claim of fair and equitable treatment, while obviating the need to meet the conditions for international wrongdoing under the treaty or customary international law.

III. INVESTMENT AGREEMENT CLAIMS UNDER THE 2004 US MODEL BIT: AN UNEASY COMPROMISE?

Contrary to the current practice in treaty arbitration discussed above, the US 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 widely adopted in other investment treaties as the umbrella clause has, considering the recent dynamic ongoing growth of BITs and FTAs particularly in Asia, the wording of the DRC should be carefully considered by counterparties to treaties with these clauses.

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 in areas such as State contracting, and, of special concern these days, unduly exposing the State to expensive litigation. As demonstrated by the US$128 million award against Argentina for violating treaty commitments inter alia the umbrella clause in September 2007, the balancing game played by States concluding investment treaties is increasingly fraught with peril. Considering these stakes, it is noteworthy then that the US 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 strong public interest. However this is facially consistent with the stated overall goal of the FTA of promoting a “stable and predictable environment for investment.”

The Structure Of The 2004 US Model BIT

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169 Sempra Award, supra, note 92

170 2004 MODEL US BIT, Preamble, supra note 3.
The 2004 US 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:

1) National treatment (Article 3);
2) Treatment no less favorable than that of the investors of the most favored-nation (MFN Article 4);
3) Free transfer of profits (Article.7);
4) 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
5) Fair market value compensation in case of legal expropriation (Article.6)

_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 3 years of when the claimant first acquired, or should have first acquired knowledge of the breach. It also declares a six-month waiting period and sets out certain notification requirements before bringing the claim.

_The subject matter jurisdiction clause_

There are broadly speaking two permissible causes of action in 2004 US Model BIT which may be claimed alone or together: a breach of a substantive obligation (a treaty claim) Article 24 (i) (A) and a breach
of an investment agreement Article 24(ii)(C) or investment authorization Article 24(ii)(B) (a contract claim). In either case, the 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.”

(Article 24 1.(b)) The investment agreement claim clearly refers to a type of claim that can be considered contractual. An investment authorization, while 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.

**Claims for Breach of an Investment Agreement**

**Definition of Investment Agreement**

An investment agreement is a written agreement with a national authority 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;

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

© to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use or benefit of the government.

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171 “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 (Section A, definition of “investment authorization”), id.

174 “National authority” means an “authority at the central level of government.”(Section A), id
Underlying qualified investment requirement

As a threshold matter, a the 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.\(^{175}\) The definition of investment specifies loosely some typical characteristics of investments for which various types 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.

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

a) an enterprise;

b) shares, stock, and other forms of equity participation in an enterprise;

c) bonds, debentures, other debt instruments, and loans;

d) futures, options and other derivatives;

\(^{175}\) 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 a 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. 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,” *supra* note 7
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.\textsuperscript{176}

This in turn is limited by:

\textit{…A claim to payment that arises solely from the commercial sale of goods and services is not an investment, unless it is a loan that has the characteristics of an investment.}

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.\textsuperscript{177}

\textit{Conditions and limitations to bringing a claim: Waiver of domestic litigation}

In either type of claim, Article 11.16 requires a claimant to provide along with a 90-day prior written notice of intent to arbitrate a written waiver of

\textsuperscript{176} 2004 Model US BIT, Article 28, \textit{supra} note 3.

\textsuperscript{177} This was the scenario in the expropriation claim in Metalclad. \textit{supra} note 61
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 11.16

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.

*Governing law of investment agreement claims*

The Governing Law Article 30.2 covering the substantive law of the arbitration states that if the claim is for a breach of an investment agreement, the Tribunal “shall apply:”

\[
i) \text{ the rules of law specified in the pertinent investment authorization or investment agreement, or as the disputing parties may otherwise agree;}
\]

or

\[
178 \text{ In the case of a breach of a substantive obligation, the dispute shall be decided “in accordance with this Treaty and the applicable rules of international law”. US Model BIT, Art. 30.1 supra note 3.}
\]
j) 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

ii) such rules of international law as may be applicable.”

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.

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 Art. 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.

A debate has long existed about the second sentence of ICSID Art. 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. Some commentators interpret “and” to mean that the tribunal is mandated to apply both domestic and international law. Tribunals have frequently adopted this concurrent approach and

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used international law to resolve certain issues in disputes over agreements governed by domestic law.\textsuperscript{180}

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.\textsuperscript{181} 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 outcome of the analysis.\textsuperscript{182}

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.”\textsuperscript{183}

\textit{The Award Clause}

The Award Clause Article 11.26 permits the Tribunal to award in separately on in combination, only:

\textbf{1. a) monetary damages and any applicable interest, and}

\textsuperscript{180} Schreuer, Christopher and August Reinish, Legal Opinion for CME Czech Republic BV v. The Czech Republic, Partial Award of September 13, 2001, para 167 – 191 LG & E\textit{ supra} note 128.

\textsuperscript{181} 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. Duke Energy,\textit{ supra} note 88

\textsuperscript{182} Schreuer, Christopher and August Reinish,\textit{ supra} note 187, para 197 p.58

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.

c) A Tribunal may also award costs and attorney’s fees …

Punitive damages are specifically disallowed. The clause does not distinguish between treaty and investment agreement claims; it is not clear that the award clause applies to a breach of an investment agreement claims at all if the governing law of the investment agreement is host state law. The drc appears to give no specific guidance on the award of damages from a breach of an investment agreement beyond the injunction to use the “rule” in the investment agreement to decide the investment agreement claim. 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?

Since the private party recovery under public contracting laws is significantly less than for commercial contracts, let alone for the typical investment treaty arbitration, the difference could be considerable.

In the BIT arbitrations with concurrent treaty and contract claims so far, remedies from the treaty damage clause were only allowed on showing of a violation of international law. However, under the drc of the US Model BIT, even when a treaty breach is not claimed, this may not be the case. Considering the Tribunal’s wide discretion to respond to the claim as it is framed by the claimant, practically speaking, the Tribunal is probably not constrained by the face of the investment agreement itself. This is due in part to the

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184 Model US BIT, Article 34.3, supra note 3

185 See Bowett. Supra n. 45, p. 50 comparing international standards of compensation for expropriation with US laws on the termination of public contracts.

186 SGS Philipinnes, supra note 91, Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/98/4 -Award on Merits, 8 December 2000
vagueness of the treaty language (what does “rule” include?) and the wide terms of reference of the drc.

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.”

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.

To raise an investment agreement claim, a qualified investor must show 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? By setting the definition of investment agreements corresponding to contracts concluded by the State exercising specifically sovereign powers, following the reasoning of Impreglio, El Paso and PAE,\textsuperscript{187} it can be argued that the treaty parties intended that a breach of an investment agreement would engage State responsibility. However, this conclusion is not warranted. First, the main reason for 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 militates against 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 emphasized the nature of the act causing the breach rather than the nature of the contract at issue.\textsuperscript{188} Neither would it 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\textsuperscript{189} 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. The governing law clause for investment agreement claims uses a general formulation for breach of an investment agreement originally derived for any kind of ICSID investment dispute. It authorizes tribunals to substitute international law for domestic law to certain

\begin{flushright}
\textsuperscript{187} El Paso \textit{supra} n. 121 and PAE \textit{supra} n. 92 \\
\textsuperscript{188} Amerisanghe, \textit{Supra}, note 58 p.884 \\
\textsuperscript{189} Crawford describes the US Model BIT’s DRC as the “the integrationist approach”\textit{supra} n. 75, p. 20.
\end{flushright}
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 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 sovereignty of States in public contracting and the disposition of natural resources.  

**Issues Raised for Arbitral Tribunals**

The investment agreement provisions present an acute case of what Zachary Douglass has described as a “symmetrical jurisdictional conflict.” 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.

**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

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190 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. Occidental *supra* note 92, para 36

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 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 SGS Philippines.192

On the other hand, claimants may argue as in Lanco, that the forum-selection clause cannot express consent, because administrative resolution in domestic courts is not selectable or is part of the mandatory laws of the host State.193 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.

*Consideration of Previous Decisions by National Courts*

Another critical legal issue the tribunal will face for the first time is should 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

192 This agrees with Douglass’ proposed “stay test” based on whether the “fundamental basis of the claim” is an investment contract or the treaty. *supra* note 71, p.283.

193 Occidental, *supra* note 92 para 36
the road” clause, and although some treaties relying on it such as the KORUS-FTA 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. “When the act 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.” 194 In investment 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. 195

In the Lowen case, the claimant alleged a denial of justice under NAFTA’s minimum standard of treatment provision Article 1105 when the Supreme Court of the US State of Mississippi 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

194 Brownlee, supra note 53 p.497
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 US Supreme Court review, the treaty tribunal would not consider the denial of justice claim.¹⁹⁶

In the Mondev case, a claimant similarly claimed a breach of the obligation to provide the minimum standard of treatment under international law under NAFTA 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 citing the sovereign immunity of the Boston Redevelopment Authority. In contrast to the Lowen case, however, the decision of the Massachusetts Supreme Judicial Court was final under US law and the claimant had exhausted all remedies in the US Court System. Deferring to the Massachusetts court, the NAFTA Tribunal stated, “It 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.”¹⁹⁷ The Tribunal went further, saying “Within 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.”¹⁹⁸

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

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¹⁹⁶ Mondev Intev Int, wi United Staes, ICSID Case No. ARB (AF)/99/2, Award Oct. 11, 2002, para 144
¹⁹⁷ Id at para 126 cited in Klaftner, supra note 203. Klaftner proposes that the exhaustion of domestic remedies rule be introduced NAFTA arbitration. See also Gus Havens, Treaty Arbitration as a Species of Global Administrative Law. EJIL, Vol. 17, No. 1, pp. 121-150, 2006 Havens believes that investment treaty arbitration is a powerful form of international administrative law review
¹⁹⁸ Klaftner, supra note 200 p. 497
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 specified international arbitration under international law in the investment agreement.

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\(^\text{199}\) 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

\[^{199}\text{Supra note 92.}\]
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 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.

V. INVESTMENT AGREEMENT CLAIMS AND THE POLICE POWERS OF STATES

This latest proposal for the treatment of State contract claims in international tribunals follows several failed approaches at the multilateral level to establish a permanent tribunal to consider investment disputes, most recently the MAI under the auspices of the OECD. MAI was controversial in part because of concerns that such a treaty would inhibit the implementation and enforcement of national, regional and international environmental laws. The investment agreement provisions raise similar objections that have since been at least been partially addressed for treaty claims of indirect expropriation.

As can be seen from 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. 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.

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

The line between compensable indirect expropriations and non-compensable regulation is not clear in international law: not all regulations may be considered indirect expropriations.\(^{200}\) 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 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”\(^{201}\)

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…\(^{202}\)

In practice, however, in expropriation cases investment tribunals have often applied domestic US


\(^{202}\) RESTATEMENT, *supra* note 70, *Section 712(1) Expropriation or Regulation, Comment g.*
regulatory takings doctrine in favor of investors, disregar disregard 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 Elana 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, whether domestic or international, the State’s obligation to pay compensation remains.”

This was cited with approval by the Tribunal in the Tecmed case based on the Spanish-Mexican BIT. 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. Further, it opined that NAFTA permitted a finding of expropriation for regulation that only incidentally interferes with expected profits.

expropriation 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.

As Phillip Sands has pointed out, these results at odds with domestic and international

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203 Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978)
204 Compania del Desarrollo de Santa Elana SA v. Costa Rica ICISD Case No. ARB/96/1 (February 17, 2000). (“Santa Elana”)
205 Tecmed, supra note 92.
206 Metalclad, , supra note 92, para 103
207 See the discussion in Sands Phillippe, PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW: (Second Edition,
environmental law stem from the current fragmented State of international law overall. National and international environmental law have not been integrated with international economic laws while investment tribunals have mainly adopted a hierarchy preferring international economic law. A striking 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. The holding amounts to international administrative review of Canada’s environmental laws:

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.

Responding to the objections of NGOS and States, many subsequent treaties have contained the following phrases also found in Annex B 4(b) of the US Model BIT clarifying 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

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209 SD Meyers v. Canada UNCITRAL (NAFTA). First Partial Award, 13 November 2000, para 258-266.

210 See Havens, supra note 205.

211 SD Meyers, supra note 220, para 221.
environment, do not constitute indirect expropriations.

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 Model BIT purports to address environmental concerns in Article 12 borrowing language from NAFTA:

Article 12: Investment and Environment. The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections affected 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.
Notwithstanding this language, under NAFTA investors have raised a multitude of claims challenging environmental or health regulations as indirect expropriations or as breaches of the obligation of fair and equitable treatment.\textsuperscript{212}

With respect to investment agreements, in the Metalclad case discussed above, 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.\textsuperscript{213} 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

\textsuperscript{212} See Sinclair, Scott, NAFTA Chapter 11 Investor-State Disputes to January 1, 2008, Canadian Center for Policy Alternatives, available at [http://www.policyalternatives.ca/reports/2008/01/reportstudies1814/?pa=6104EA04] see also the US State Department’s Summary of Cases Filed under NAFTA available at [http://www.state.gov/s/l/c3439.htm] Ethyl Corporation v. Canada (challenging ban on MMT); Sunbelt Water v. Canada (“water protection legislation); Chemtura Corp. v. Canada (“ban on pesticide lindane), Albert Connolly v. Canada (“order under natural heritage protection program), Metalclad, (“failure to grant operating permit pursuant to waste management regulations, designation of site as ecological buffer zone) supra note 61; Glamis Gold v. United States (relating to preservation of Indian sacred sites in a mining operation), Methanex v. US (challenging California ban on MTBE) Tecmed(challenging the revocation of a permit for a toxic waste facility) supra note 61; Dow Chemical recently announced the application for NAFTA arbitration to challenge a Canadian pesticide ban. Also in progress is James Russell Baird v. the United States: An investor owning a patent in the US for the disposal of toxic chemicals alleges that this “investment” has been expropriated by the Nuclear Waste Policy Act of 1995, 1997, and 1999

\textsuperscript{213} Azurix, supra, n. 61
a breach of the duty of fair and equitable treatment under the US 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\textsuperscript{214}. The Tribunal awarded Azurix for US$165 million of the more than US$600 million it was claiming.\textsuperscript{215} Argentina has applied for an annulment.

Kate Miles has pointed out the imminent prospective conflict between global-warming related regulation and international investment law;\textsuperscript{216} 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 renewable energy portfolio requirements, 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.\textsuperscript{217}

\textit{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

\textsuperscript{214}Azurix, supra note 61, Paras 316 - 323
\textsuperscript{215}Id.
\textsuperscript{217}Vattenfall AB, an energy generation company owned by the Swedish government initiated proceedings against Germany in (Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. Federal Republic of Germany ICSID Case No. ARB/09/6 – reported in the Investment Arbitration Reporter, April 2, 2009 http://www.iareporter.com/index_free_archive.html
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 Elana Tribunals, disregarding the non-discriminatory purpose behind environmental regulations when assessing investment agreement violations, the chilling effect on environmental regulations could be serious.

Because multinationals often have resources for evasion far exceeding the enforcement capacities of host States, environmental protection in developing countries is already severely challenged. If the investment agreement contains a stabilization clause, the provisions may be deemed to absolutely fetter governments’ 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. As one author puts it, “Besides the continued application of low standards for decades to come, this situation also shifts the risk to the host state of currently unknown social and environmental standards which may be prevented or minimized through regulation.”

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

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218 Cotula, *supra* note 16, p. 12
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 management guidelines for their implementation, the investment agreement provisions, too broadly construed, would easily blur such distinctions.

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 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.219 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.

219 Collins, David. An Economic Justification for Reliance Damages at ICSID. Available at http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=david_collins. Collins observes that it is in fact a common approach of ICSID tribunals to award reliance damages in expropriation cases. He also argues the practice is economically efficient while preserving confidentiality of information of the parties to the arbitration.
Although a discussion of the validity of stabilization clauses under international law is well 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). If the investment agreement has a valid stabilization clause, 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.

### Interpretation of the Governing Law Clause and Award Clauses for Investment Agreement Claims

<table>
<thead>
<tr>
<th>Nature of Challenged Measure</th>
<th>Existence of valid stabilization clause</th>
<th>Whether tribunal must find breach of investment agreement</th>
<th>Whether international law may be applied to the breach of the investment agreement, absent express provision in the investment agreement</th>
<th>Type of damages to be applied</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discriminatory</td>
<td>Yes</td>
<td>Depends on the scope of the stabilization clause</td>
<td>Yes</td>
<td>Damages under the investment agreement, reliance damages under the treaty’s award clause, or restitution, whichever is greater.</td>
</tr>
<tr>
<td>Discriminatory</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Reliance damages under the treaty’s award clause, or restitution, whichever is greater</td>
</tr>
<tr>
<td>Non-discriminatory</td>
<td>Yes</td>
<td>Depends on the scope of the stabilization clause</td>
<td>No</td>
<td>Remedies provided for in the investment agreement or host-state law</td>
</tr>
<tr>
<td>Non-discriminatory</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>None</td>
</tr>
</tbody>
</table>
VI. CONCLUSION

This article has discussed the origins and implications of the procedural framework for the arbitration of investment agreements under the 2004 US Model BIT from both legal and policy perspectives. Under the proposed 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 or in contemporary BIT practice. Government measures in the field of environmental enforcement and natural resources management are particularly likely to become sources of investment disputes and potential liability for host States. The investment agreement provisions of dispute resolution clause, broadly interpreted, opens alternative avenues for investors to claim contractual expectation damages against the public sector for breaches of obligations in concession contracts that are not contemplated in the public contracting laws of the States. Due to the largely unprecedented introduction of contract claims into treaty arbitration, the resolution of investment disputes under the investment agreement provisions may yield conflicting outcomes in relatively common investment situations for some time, undermining the goal of securing stable investment flows for countries that use them in investment treaties. Finally, depending on how tribunals construe them, the provisions 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 between environmental enforcement and international investment law and to reconcile the provisions with customary international law and investment arbitration precedents.