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In the Eyes of the Beholder: Host State's Refusal to Pay under a Contract as Breach of a BIT

Inna Uchkunova (International Moot Court Competition Association (IMCCA)) · Tuesday, May 7th, 2013

and Oleg Temnikov

I. Bureau Veritas v. Republic of Paraguay

In the recent *Further decision on objections to jurisdiction dated October 9, 2012* the tribunal in *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Paraguay* (ICSID Case No. ARB/07/9) dismissed BIVAC's claim based on violation of the fair and equitable standard by reasoning that the dispute relates to mere refusal to pay invoices under a pre-shipment inspection contract and that, in doing so, Paraguay has not acted "in a manner that is qualitatively different from an ordinary contracting party." The tribunal thus upheld the traditional distinction between mere breach of contract and treaty breach stating that "[s]omething more than mere breach of contract is needed." (para. 246)

II. The traditional conception of the contract-treaty divide

Under the dogmatic conception of the contract-treaty divide, "the breach by a State of a contract does not as such entail a breach of international law. Something further is required… *such as a denial of justice by the courts of the State…*" (Comm. 6 to Art. 4 ILC's Articles on State responsibility; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina*, ICSID Case No. ARB/97/3, Decision on annulment, 3 July 2002, para. 95; etc.) In this regard, the BIVAC tribunal noted that it does not exclude the possibility that:

> "a substantial breach of a contract could, as such, give rise [sic] a breach of [the FET standard]… [but] even [assuming that such a situation could] arise, *the continued unhindered availability of a contractually agreed forum…* would be a significant factor imposing an additional hurdle for a claimant to overcome." (para. 246)

III. Can the investor succeed on a claim for expropriation or breach of the FET standard based on the host State's refusal to pay?

The authors do not deny the traditional view of the contract-treaty divide. However, we find it more intellectually challenging to argue here for the investor who is faced with such an "*additional*

hurdle". Can he succeed on a claim of expropriation or breach of the FET standard that is a *treaty claim*? Moreover, it turns out that under the dogmatic view, a State may escape international responsibility by merely refusing to pay under a contract instead of taking covert measures which fall squarely into the definition of expropriation.

At the outset, we make the clarification that we are dealing here with the scenario in which the underlying contract qualifies as protected investment under the applicable BIT, the BIT does not contain an umbrella clause and the contract contains a forum selection clause referring all disputes to the host State's courts. (Cf. *Siemens A.G. v. the Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 249)

3.1. The test of puissance publique is irrelevant

Previous tribunals dealing with the question of whether breach of contract may amount to expropriation or breach of the FET standard have applied a test of *puissance publique*, that is, they have sought to satisfy themselves that the State, in breaching the contract, acted in sovereign capacity (by e.g. enacting a law or decree attempting to expropriate or annul the debt) rather than as mere contracting party. (*SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision on jurisdiction, 29 January 2004, para. 161; etc.)

In the words of the *Consortium RFCC v. Morocco* tribunal:

> "a State may perform a contract badly, but this will not result in a breach of treaty provisions, unless it be proved that the state… has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign." (ICSID Case No. ARB/00/6, Award, 22 December 2003, para. 65 translated in *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 53)

Thus, the *BIVAC* tribunal held that, in refusing to pay, Paraguay acted as mere contracting party. (para. 246) On the facts, however, it seems strange to qualify the conduct of investigations and the establishment of a special Commission as ordinary commercial acts. (paras. 51, 60)

In any event, international law does not distinguish for the purposes of State responsibility whether the State acted as holder of *jure imperii* or not. (See Comm. 6 to Art. 4 of the ILC's Articles on State responsibility) Notably, the tribunal in *Bayindir Insaat Turizm Ticaret ve Sanayi A.?. v. Pakistan* determined that:

> "the test of '*puissance publique*' would be relevant only if Bayindir was relying upon a contractual breach… In the present case, Bayindir… *pursues exclusively Treaty Claims*. When an investor invokes a breach of a BIT by the host State… the alleged treaty violation is by definition an act of 'puissance publique'." (ICSID Case No. ARB/03/29, Decision on jurisdiction, 14 November 2005, para. 183)

Similarly, in *Impregilo S.p.A. v. Pakistan*, the tribunal determined that:

> "Only the State in the exercise of… *puissance publique* and not as a contracting party, may breach the obligations assumed under the BIT." (ICSID Case No. ARB/03/3, Decision on jurisdiction, 22 April 2005, para. 260)

However, when making this statement the tribunal was speaking of Impregilo's claims regarding unforeseen geological conditions which are outside the sovereign activity or even the control of the State. (para. 268; Cf. para. 284)

On the other hand, the case mostly cited in support of the view that "mere non-performance of a contractual obligation is not to be equated with a taking of property" is *Waste Management*. (*Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 174) Close examination or the text of the award shows, however, that the tribunal did not deny that "the outright refusal by a State to honour a money order or similar instrument… may well constitute… an actual expropriation." (para. 168) The tribunal went on to distinguish the case at hand in that "[t]he question here is not one of final refusal to pay (combined with effective obstruction and denial of legal remedies)…" (para. 176; as to 'denial of legal remedies' see infra 3.3.) Rather, the tribunal referred to the Mexican financial crisis which affected payment under the contract. (para. 112)

3.2. The intention of the host State shall be taken into account

Some tribunals have looked to the intention of the State. Thus, the investor's claim in *Waste Management* could have succeeded had it shown evidence of "sectoral or local prejudice." (para. 115; see also, *Impregilo S.p.A. v. Argentina*, ICSID Case No. ARB/07/17, Award, 21 June 2011, para. 278; *Eureko B.V. v. Poland* (Netherlands-Poland BIT ad hoc arbitration) Partial Award, 19 August 2005, para. 233) Be that as it may, our main proposition is that, even without providing evidence of the State's motivation, the investor may overcome the aforesaid jurisdictional hurdle.

3.3. Recourse to local courts is not a pre-condition for treaty claims

Under the dogmatic view as above described, "[a] mere refusal to pay a debt is not an expropriation of property… *where remedies exist* in respect of such a refusal." (*SGS v. Philippines*, para. 161) The problem with this proposition is that, absent contrary stipulation in the BIT, the exhaustion of local remedies is not a prerequisite to an ICSID tribunal's jurisdiction, rather the idea was to dispose of this requirement. (See Article 26 ICSID Convention)

Therefore, a forum selection clause found in the underlying contract – providing for the jurisdiction of the host State's courts in contractual matters – shall not obstruct the investor's treaty claims. (See e.g. *Vivendi v. Argentina*, para. 101)

Importantly, the Committee in *Helnan International Hotels A/S v. Egypt* has held:

> "[Such a requirement would] do by the back door that which the Convention expressly excludes by the front door… [I]t would empty the development of investment arbitration of much of its force and effect, if, despite a clear intention of States parties not to require the pursuit of local remedies as a pre-condition to arbitration, such a requirement were to be read back in… It would leave the investor only with a complaint of unfair treatment based upon denial of justice." (ICSID Case

> No. ARB/05/19, Decision on annulment, 14 June 2010, paras. 47, 53)

Similarly, the tribunal in *Alpha Projektholding GmbH v.Ukraine* observed:

> "Whether Claimant could have enforced its rights in local courts… is not relevant… Claimant chose to seek a remedy through international arbitration instead, as it is entitled to do." (ICSID Case No. ARB/07/16, Award, 8 November 2010, para. 411)

In this regard, the *BIVAC* tribunal's reasoning that "a substantial breach of a contract could constitute a violation of a treaty [so far as there is] preliminary determination" by the competent local court (para. 274) is to be criticized for dismissing the investor's claim without a second thought.

3.4. The investor's legitimate expectations include the host State's obligation to observe contractual obligations

As to the FET standard, in finding no arguable case under it, the BIVAC tribunal noted that "the Claimant has not been able to cite any authority for the proposition that international law imposes any obligation as such on a State to pay moneys owing under a contract." (para. 270) Such a sweeping statement shall be measured against other decisions in which there is support for the proposition that observance of contracts falls into investor's legitimate expectations. Thus, the tribunal in *Toto Costruzioni Generali S.P.A. v. Lebanon* observed that "[l]egitimate expectations may follow from… representations made by the host state, or from its contractual commitments." (ICSID Case No. ARB/07/12, Award, 7 June 2012, para. 159)

Moreover, the tribunal in *Noble Ventures, Inc. v. Romania* stated:

> "[The FET] standard… can be consider[ed] to be a more general standard which finds its specific application in inter alia the duty… *to observe contractual obligations towards the investor*." (ICSID Case No. ARB/01/11, Award, 12 October 2005, para. 182)

Further, the tribunal in *Impregilo S.p.A. v. Argentina* dismissed Impregilo's claim based on the FET standard stating that "the existence of legitimate expectations and the existence of contractual rights are two separate issues." (para. 292) But the sole reason upon which the tribunal based its pronouncement was the test of *puissance publique* (para. 294) and we already showed above why this reasoning is not persuasive.

IV. The need for reconsideration

The above survey of arbitral practice shows that the existing inconsistency of decisions and the preconception that a host State's refusal to pay under a contract does not amount to expropriation or breach of the FET standard deserve further clarification.

This will also affect the question of admissibility of claims and stay of proceedings in cases such as *SGS Société Générale de Surveillance S.A. v. Pakistan* (ICSID Case No. ARB/01/13, Decision on

jurisdiction, 6 August 2003), *SGS v. Philippines* and *BIVAC*. The preferred approach is that in *SGS v. Paraguay* where the tribunal held that treaty claims are not co-extensive with contract claims "they are not necessarily disposed of by the four corners of the Contract." (*SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case No. ARB/07/29, Decision on jurisdiction, 12 February 2010, para. 173) The tribunal, therefore, declined to stay proceedings awaiting the decision of the national court, otherwise it would be "at risk of failing to carry out its mandate" (para. 172) which is a ground for annulment under Article 52(1)(b) ICSID Convention.

V. Conclusion

As the tribunal in *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States* (ICSID Case No. ARB(AF)/97/2, Award, 1 November 1999) noted "[l]abelling is… no substitute for analysis… The egregiousness of any breach is in the eye of the beholder…" (para. 90)

This analysis shows that neither the test of *puissance publique*, nor the existence of available local remedies is a good reason to dismiss claims for expropriation or breach of the FET standard based on the State's 'mere' refusal to pay. It is hoped that arbitrators will keep an open eye and more importantly, an open mind, when facing such claims in the future.

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