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Sovereign Actions, Special Laws, and Contractual Obligations in Investment Arbitration

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Balancing the concurrent rights of sovereign states to regulate in their interest and of foreign investors to be afforded certain standards of protection when investing in a foreign jurisdiction often leads to complex questions in investment arbitration claims. One uncommon, but not entirely novel issue, which was again brought to light in *Iskandar Safa and Akram Safa v. Hellenic Republic* is the line between contractual claims and treaty-based claims. This case raises the question of whether a host state's special law nullifying contractual obligations between a state and a foreign investor may raise what would otherwise be a contractual dispute to the status of an arbitral dispute under an investment treaty. Readers can find the facts of the case in a previous blog post, as well as a discussion on treaty claims originating from contractual disputes.

This post examines the characterisation of special laws as sovereign acts for the purposes of an investment treaty claim. We discuss how such acts, whether intended to avoid contractual obligations or to minimise the impacts of an economic crisis, result in the same exposure to an investment treaty claim by foreign investors.

The Issue in *Safa*

The case at hand arises from measures taken by the Greek government with respect to Hellenic Shipyards S.A., a Greek company owning and operating a shipyard and indirectly owned by the claimants. The special law enacted by Greece had overridden contractual obligations between the Greek Government and the Turkish investor. In *Safa*, the claims by the investor included a number of claims brought in two separate arbitrations. Many of Safa's claims were ruled out at the jurisdictional stage, with the Tribunal agreeing with Greece that the claims were partially inadmissible because the alleged breaches were based on contractual claims, rather than on the applicable bilateral investment treaty ("BIT") (the Greece-Lebanon BIT). However, the Tribunal agreed with the claimant that the enactment of the Greek special law was more than just a contractual claim. The Tribunal found that the law allowed Greece to carry out works 'free of charge', which would have been a breach of the contract with the investor, and the special law effectively allowed the investor's only customer to use the shipyard without charge. The Tribunal agreed with the investor that the takeover of the shipyard *free of charge* by virtue of the special law was a unilateral sovereign act that effectively frustrated the investor's legitimate expectations to operate the shipyard. Greece was found to have bypassed the options that were open to it to resolve the contractual dispute, acting instead beyond the scope of the contract in exercising sovereign powers and thus in breach of the fair and equitable treatment ("FET") standard under the BIT.

Investment Disputes over 'Special Laws'

Looking back at an earlier example of this type of claim, the Argentine government in *Abaclat and Others v. Argentine Republic* was found to have promulgated a law 'entitling it not to perform part of its obligations' (para. 323) under the relevant contractual agreement. However, in contrast to *Safa*, this was not a relatively isolated dispute as it stemmed from Argentina's response to the economic recession and default of sovereign debt in the 2000s. The Tribunal considered the question of whether the relevant dispute was of a contractual nature or if it constituted a treaty claim under the relevant BIT. The claim related to the sovereign bonds issued by Argentina to Italian investors in different currencies and listed on a number of international exchanges, and the default in 2001 which deprived the investors of their investments in the bonds. Considering the matter as a jurisdictional issue, the Tribunal (by majority) found that the Argentinian Government had intervened 'by virtue of its State power' to modify the contractual obligations owed to the Claimants and that such a sovereign act fell under the jurisdiction of the Argentina-Italy BIT. In particular, the Emergency Law by Argentina was found to unilaterally modify its payment obligations without any contractual basis for doing so.

More than a simple question of 'contract or treaty', the peculiarity of a state enacting a law to excuse itself from performing contractual obligations, instead of liberating it from the binds of private law obligations, has had the opposite impact of drawing it into the jurisdiction of an arbitral tribunal. In his dissenting opinion, Georges Abi-Saab questioned whether an arbitral tribunal is the correct forum for such claims in the context of sovereign debt crisis management, finding that such investments in sovereign debt instruments lacked the necessary territorial link for an investment claim under the BIT and the ICSID Convention. In *Abaclat*, the matter was settled, and therefore no final award was issued. However, the majority of the Tribunal established that the question of a law enacted by a host state which effectively voids its contractual obligations owed to an investor is a question of jurisdiction, and that such an action is not purely a contractual claim but is also a treaty-based claim due to the sovereign nature of the action taken by the state.

Other cases heard at the same time as *Abaclat* considered the above approach. In *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka* ("Deutsche Bank") the Tribunal agreed that when a state intervenes 'as a sovereign by virtue of its State power to modify its payment obligations' under a contract, such intervention is to be taken as a sovereign act and impacts on the rights and obligations owed by the state to an investor under an investment treaty. The same approach was endorsed by the Tribunal in *Ambiente Ufficio S.p.A. and others v. Argentine Republic* ("Ambiente"), where it was echoed that failure to comply with contractual obligations, followed by the enactment of a law in relation to such failings, may cause the action to find jurisdiction as a treaty claim and not simply a contractual one.

Reconciling Special Laws and Contractual Obligations

The question, therefore, goes to jurisdiction and can effectively elevate what might have just been a contractual breach to the status of a treaty breach, whereby a state seeks to excuse itself from previous contractual obligations through legislation. If, alternatively, Argentina had simply failed to pay, and the Greek government had failed to pay for the use of the shipyard to complete the naval vessel constructions, then these matters might have never escalated to the investment arbitration stage. Such conclusions, however, may send the message to states defaulting on contractual obligations that they should do so without attempting to legitimise the failure to perform under domestic legislation. In such a scenario, from the perspective of liability, states may simply default and allow the investor to pursue the claim through domestic, private law remedies, rather than risk a treaty claim in which an investor can resort to remedies beyond what has been established under an investment contract.

Conclusion

Tribunals are charged with the difficult task of assessing whether sovereign acts such as special laws give rise to breaches of investment treaties or if such acts simply trigger contractual disputes between investors and states. It appears that where a special law to circumvent contractual obligations is found to give rise to an arbitral claim, the intention of such a special law is not decisive to the finding of a breach. Regardless of intent, enacting a special law may attract an investment arbitral claim. Whether it is to modify payment obligations owed to an investor, as in *Safa* and *Deutsche Bank*, or to respond to an economic crisis, as in *Abaclat* and *Ambiente*, the intention of a special law will not impact whether it falls within the jurisdiction under an investment treaty. States should be cognisant of this when responding to contemporary issues through special legislation.

What is most important is the impact of the special law on the foreign investor’s rights under the relevant investment treaty, and whether its rights under the relevant treaty are compromised by the operation of the special law. This raises concerns about the regulatory autonomy of states and the ability of states to adequately respond to regulatory challenges as they arise, without the risk of exposure to foreign investment claims. Such concerns cannot be resolved by investment tribunals, but suggest that states should look at the nature and terms of investment treaties to set clear boundaries for the types of claims that may be brought against them.

In the meantime, instead of legislating to avoid or circumvent contractual obligations owed to foreign investors, states would be better advised to renegotiate or default under the terms of the contract to avoid the escalation of the dispute to the arena of investment arbitration.

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This entry was posted on Thursday, June 12th, 2025 at 8:01 am and is filed under Contract Interpretation, Domestic law, International Investment Arbitration, International Investment Law, Investment agreements, Investment Arbitration, Investment Disputes, Investment law, Investment protection, Investment Treaties, Investor-State arbitration, ISDS, Sovereignty
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