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# Responsibility of the State Under International Law for the Breach of Contract Committed by a State-Owned Entity

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## I. INTRODUCTION

In many countries, entities that are owned by the state but possess a separate legal personality (“state-owned entities”<sup>1</sup>) play a key role in strategically important sectors. State-owned entities are especially common in utilities and infrastructure industries such as production and distribution of energy (hydroelectric power, oil, gas, and coal), posts and telecommunications, transportation (railway, airports and airlines), and financial services.<sup>2</sup> Foreign investors looking to participate in such businesses frequently enter agreements with state-owned entities. When a state-owned entity breaches the agreement,

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1. State-owned entities may be fully, majority or minority owned by the state. As a survey of the Organization of Economic Co-operation and Development (“OECD”) dating from 2005 has revealed, on average, in OECD countries more than half of the state-owned entities are fully owned by the state and twenty percent are majority owned. OECD, CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 33 (2005). State-owned entities often take the form of regular private entities and are subject to the same corporate regulations; in OECD countries, the most common legal form of state-owned entities is the private limited liability company, the joint stock company is second most-common. *Id.* at 36.

2. *Id.* at 34; OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 9 (2005).

foreign investors often seek to address their claim directly against the host state.

This article analyzes several questions that are relevant for assessing whether the state can be held responsible for a contractual breach by state-owned entities. To begin, I look briefly at choice of forum considerations that motivate investors to pursue direct state responsibility. Then, I examine the legal grounds on which and circumstances under which the conduct of a state-owned entity can be attributed to the state. Based on that framework, I then analyze which international obligations might be infringed by a breach of contract. Last, I address specific questions in relation to the responsibility of the state under the Energy Charter Treaty of 1994 (“ECT”).

## II.

### INVESTORS’ MOTIVATION TO OBTAIN ICSID JURISDICTION

One motive for pursuing direct responsibility of a state is that the state-owned entity might not have sufficient funding to meet the resulting award. Another reason will often be that the investor wishes to submit the dispute to the International Centre for Settlement of Investment Disputes (“ICSID”). While the first motive is quite evident, the latter may need further explanation.

ICSID has jurisdiction for disputes arising directly out of an investment between a contracting state of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID Convention”) and the national of another contracting state, provided the parties gave their consent in writing.<sup>3</sup> Generally, the investor will seek to submit its claim to ICSID if he believes that the courts in the host state will not adjudicate the dispute impartially and independently. Even if the investment agreement concluded with the state-owned entity calls for arbitration, for example under the Arbitration Rules of the United Nations Commission on International Trade Law, the investor might still prefer to bring its case before ICSID because ICSID arbitration possesses several characteristics which make it particularly attractive for an investor. For instance, an ICSID award is not subject to any review not foreseen in the ICSID Convention and is to be recognized by the contracting states as if it were a final judgment of a court in that state.<sup>4</sup> In addition, host states have a strong incentive to comply with ICSID awards because of the institutional link of ICSID to the World Bank.<sup>5</sup>

Accordingly, the substantive question of direct state responsibility has important strategic and practical ramifications. Against this background it becomes clear why the investor will often argue that the host state itself is

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3. ICSID Convention art. 25(1).

4. ICSID Convention arts. 53(1), 54(1).

5. See CHRISTOPH SCHREUER, THE WORLD BANK/ICSID DISPUTE SETTLEMENT PROCEDURES, available at <http://www.univie.ac.at/intlaw/ICSID.pdf> (last visited Feb. 17, 2010).

responsible for the breach of contract committed by one of its entities. The respondent state, in turn, can be expected to deny its responsibility by pointing out that the contract was concluded with an entity which enjoys its own legal personality. In addition, the state will quite likely argue that the ICSID tribunal does not have jurisdiction to hear a claim based on the alleged breach of contract.

### III.

#### ATTRIBUTION OF CONDUCT OF A STATE-OWNED ENTITY TO THE STATE

The first step to establish state responsibility is to determine whether the breach of contract committed by a state-owned entity can be attributed to the state. This section first explains why attribution is relevant both from a procedural and a substantive perspective. Thereafter, it examines the legal grounds on which—and the circumstances under which—acts of a state-owned entity can be attributed to the state.

##### A. *Twofold Relevance of Attribution*

In order to establish state responsibility, it must first be determined whether the breach of contract committed by a state-owned entity can be attributed to the state. This question has twofold relevance. It is dispositive to decide both 1) whether a tribunal has jurisdiction under the ICSID Convention, and 2) whether the state is liable for such conduct. Thus, this question is of importance from both a procedural and a substantive perspective.

Under article 25(1) of the ICSID Convention, the jurisdiction of ICSID only extends to disputes between a contracting state and a national of another contracting state. ICSID lacks jurisdiction to arbitrate disputes between two private parties. If the act of a state-owned entity cannot be attributed to the state, ICSID does not have jurisdiction. Moreover, a state can only be held liable for acts of its entities if such conduct is attributable to the state. If the act cannot be attributed to the state, it has no responsibility towards the investor.

The twofold relevance of attribution was aptly observed by the tribunal in *Maffezini v. Kingdom of Spain*.<sup>6</sup> The tribunal thereby rightly noted that “[w]hile the first issue is one that can be decided at the jurisdictional stage of these proceedings, the second issue bears on the merits of the dispute and can be finally resolved only at that stage.”<sup>7</sup> Since attribution is relevant in both stages

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6. *Maffezini v. Kingdom of Spain*, Award on Jurisdiction, ICSID Case No. ARB/97/7, para 75 (Jan. 25, 2000) (“[T]he Tribunal has to answer the following two questions: first, whether or not SODIGA is a State entity for the purpose of determining the jurisdiction of ICSID and the competence of the Tribunal, and second, whether the actions and omissions complained of by the Claimant are imputable to the State.”).

7. *Id.*

of the proceeding, the question arises as to what extent the tribunal should accept the investor's substantive case when establishing its jurisdiction. This question is of course especially relevant when the tribunal wishes to bifurcate procedure between jurisdiction and the merits, as often occurs in investment disputes.<sup>8</sup>

In *Maffezini*, the tribunal concluded that at the procedural stage it is sufficient if the investor is able to make a *prima facie* case that the acts of the state-owned entity are attributable to the state.<sup>9</sup> It left the substantive determination of whether the claimed acts and omissions can properly be attributed to the state to be assessed during proceedings on the merits.<sup>10</sup>

The *prima facie* test is in fact a well established threshold for determining jurisdiction in investment dispute cases, especially with regard to *rationae materiae*.<sup>11</sup> Further examples in which an ICSID tribunal applied the *prima facie* test are *CMS v. Argentina*<sup>12</sup>, *SGS v. Philippines*<sup>13</sup> and *Salini v. Jordan*.<sup>14</sup> Non-ICSID tribunals have also applied the *prima facie* test, as in the case of *UPS v. Canada*.<sup>15</sup>

#### B. *The ILC Articles on Responsibility of States for Internationally Wrongful Acts*

The relevant rules on attribution for the purpose of state responsibility under international law are contained in the Articles on Responsibility of States for Internationally Wrongful Acts ("ILC Articles"). The International Law Commission ("ILC") adopted the final version of the ILC Articles at its fifty-third session in August 2001. In December 2001, the United Nations General Assembly adopted Resolution 56/83, which "commend[ed] [the articles on responsibility of States for internationally wrongful acts] to the attention of Governments without prejudice to the question of their future adoption or other appropriate action."<sup>16</sup> The ILC Articles are not a treaty which is in force, but

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8. Audley Sheppard, *The Jurisdictional Threshold of a Prima-Facie Case*, in P. MUCHLINSKI ET AL., EDS., *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW* 941-2 (2008).

9. *Maffezini*, *supra* note 6, at para. 89.

10. *Id.*

11. Sheppard, *supra* note 8, at 960, 933.

12. *CMS Gas Transmission Company v. The Argentine Republic*, Decision on Jurisdiction, ICSID Case No. ARB/01/8, paras. 22, 35 (July 17, 2003).

13. *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, Decision on Jurisdiction, ICSID Case No. ARB/02/6, paras. 26, 157 (Jan. 29, 2004).

14. *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Jordan*, Decision on Jurisdiction, ICSID Case No. ARB/02/13, para. 151 (Nov. 9, 2004).

15. *United Parcel Service v. Canada*, Award on Jurisdiction, UNCITRAL (NAFTA), paras. 30-37 (Nov. 22, 2002).

16. GA Res. 56/83, para. 3 (2001), available at <http://www.un.org/Depts/dhl/resguide/r56.htm>

tribunals and commentators alike consider the ILC Articles to “accurately reflect customary international law on state responsibility.”<sup>17</sup>

### C. *The ILC Articles in Investor-State Disputes*

Not infrequently respondent states argue that the ILC Articles cannot be applied in investor-state disputes because the ILC Articles solely address responsibilities as between states.<sup>18</sup> However, this argument is not convincing. Article 1 of the ILC Articles reads as follows:

*Article 1. Responsibility of a State for its internationally wrongful acts*

Every internationally wrongful act of a State entails the international responsibility of that State.<sup>19</sup>

The commentary to the ILC Articles as adopted by the ILC in 2001 (the “Commentary”) points out that article 1 of the ILC Articles “covers all international obligations of the State and not only those owed to other States.”<sup>20</sup> Thus, article 1 is clearly not limited to obligations to other states. The Commentary continues that state responsibility extends to breaches of international law where the primary beneficiary of the obligation breached is an *individual* or an *entity other than a state*.<sup>21</sup> Based on these passages, “there is no doubt that the ILC Articles may also be relevant with respect to non-state parties”<sup>22</sup> and that “[they] are applicable to investment arbitrations.”<sup>23</sup> This view is shared by most commentators.<sup>24</sup>

This opinion is also in line with the practice of several arbitral tribunals that have applied the ILC Articles to investor-state disputes. For instance, in *Maffezini*,<sup>25</sup> *Noble Ventures, Inc. v. Romania*,<sup>26</sup> and *Eureko v. Poland*,<sup>27</sup> the

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(last visited Feb. 17, 2010).

17. Kaj Hobér, *State Responsibility and Attribution*, in MUCHLINSKI, *supra* note 8, at 553. *See also* Noble Ventures, Inc. v. Romania, Award, ICSID Case No. ARB/01/11, para. 69 (Oct. 12, 2005) (“While those Draft Articles are not binding, they are widely regarded as a codification of customary international law.”)

18. Hobér, *supra* note 17, at 552.

19. ILC Articles, art. 1.

20. *Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001*, [2001] 2 Y.B. INT’L LAW COMM’N 87.

21. *Id.* at 87-88; see also at 32.

22. Hobér, *supra* note 17, at 553.

23. Kaj Hobér, *State Responsibility and Investment Arbitration*, in C. RIBEIRO, ED., INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 266 (2006) (citations omitted).

24. Karl-Heinz Böckstiegel, *Applicable Law to State Responsibility under the Energy Charter Treaty and other Investment Protection Treaties*, in RIBEIRO, *supra* note 23, at 259 (“And most commentators agree that [the ILC Articles] are applicable not only between states, but also for relations between states and foreign investors insofar as these are subject to international law such as in the ECT.”)

25. *Maffezini*, *supra* note 6.

ILC Articles were used to determine whether an act of a state organ or of a state-owned entity can be attributed to the state. There is thus a widespread understanding that the rules of international customary law on state responsibility as formulated in the ILC Articles cover obligations of the state towards individuals and legal entities and are therefore applicable to investor-state disputes.

*D. Structure, Function, or Control as a Necessary Element for Attribution Under the ILC Articles*

The ILC Articles contain several provisions on attribution: Article 4 refers to conduct of state organs, article 5 to conduct of persons or entities exercising elements of governmental authority, and article 8 to conduct directed or controlled by a state. Articles 4, 5, and 8 each set forth a basis for attribution to the state. However, the main focus of this article lies on article 5. Article 5 reads as follows:

*Article 5. Conduct of persons or entities exercising elements of governmental authority*

The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.<sup>28</sup>

The Commentary makes clear that article 5 is meant to cover a wide variety of bodies which, though not organs, may be empowered to exercise elements of governmental authority. According to the Commentary, this includes public corporations, semipublic entities, public agencies and even private companies, provided that in each case the entity is empowered by the law of the state to exercise functions of a public character normally exercised by state organs, and the conduct of the entity relates to the exercise of the governmental authority concerned.<sup>29</sup>

Accordingly, attribution under article 5 is based on a functional assessment (“The conduct of a person or entity . . . which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law”).<sup>30</sup> The dispositive element in article 5 of the ILC Articles is “governmental authority.” In order to determine whether an act is governmental, the Commentary proposes to rely on the particular

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26. *Noble Ventures*, *supra* note 17, at 69-70.

27. *Eureko B.V. v. Republic of Poland*, Partial Award and Dissenting Opinion, 33-34 (*ad hoc* arbitration seated in Brussels, Aug. 19, 2005).

28. ILC Articles, art. 5.

29. ILC Articles with commentaries, *supra* note 20, at 43.

30. ILC Articles, art. 5.

society, its history and traditions.<sup>31</sup> According to an alternative approach, the assessment should be based upon a comparative standard and it should be determined from an objective point of view whether the act is normally regarded as governmental in a contemporary setting.<sup>32</sup>

By contrast, attribution under article 4 depends on a structural assessment (“The conduct of any State organ shall be considered an act of that State under international law . . . whatever position it holds in the organization of the State”).<sup>33</sup> In article 8 of the ILC Articles, attribution is based on control (“The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State”).<sup>34</sup>

Attribution can be based on either article 4, 5 or 8. Thus, in order to attribute conduct that constitutes a breach of international law to the state, it is sufficient if one of the elements is present in the entity that carried out that conduct: the entity is an organ of the state (structure), it is empowered to “exercise elements of the governmental authority” (function), or it is controlled by the state (control).

A good example for a diligent analysis of whether a certain conduct of an entity is attributable to the state is *Maffezini*.<sup>35</sup> Emilio Augustín Maffezini, a citizen of Argentina, together with the private Spanish corporation Sociedad para el Desarrollo Industrial de Galicia (“SODIGA”), established a Spanish corporation named Emilio A. Maffezini S. A. (“EAMSA”) for the production of chemical products in Galicia, Spain. The project failed, and Maffezini brought suit against Spain on the argument that the failure was the result of acts and omissions of SODIGA. Since SODIGA was a public entity, so the argument continued, its wrongful acts and omissions were attributable to Spain.<sup>36</sup> Spain, however, essentially relied on a structural assessment when it maintained that SODIGA was a private entity whose conduct cannot be attributed to Spain.<sup>37</sup>

The tribunal initially clarified that even under the structural test it was clear that companies such as SODIGA could not be held to fall entirely outside the overall scheme of public administration. In fact, the tribunal observed, there existed a variety of public entities that were governed by private law but which would occasionally exercise public functions that were governed by public law.

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31. ILC Articles with commentaries, *supra* note 20, at 43. *See also* Hobér, *supra* note 17, at 270.

32. RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 200 (2008).

33. ILC Articles, art. 4.

34. ILC Articles, art. 8.

35. *Maffezini*, Award on the Merits, ICSID Case No. ARB/97/7 (Nov. 13, 2000).

36. *Maffezini*, Award on Jurisdiction, *supra* note 6, at para. 72.

37. *Id.* at 73. *See also* Award on the Merits, *supra* note 35, at para. 47.

However, the tribunal noted that the structural test was but one element to be taken into account. Other elements to which international law looked were, in particular, the control of the company by the state or state entities and the objectives and functions for which the company was created.<sup>38</sup>

The tribunal continued by stating that it would rely on a functional test in order to establish whether the conduct of SODIGA was governmental rather than commercial in nature and, hence, could be attributed to Spain.<sup>39</sup> After applying the functional test, the tribunal arrived at the interim conclusion that the conduct of SODIGA was partially governmental and partially commercial in nature. Since only the former were attributable, the tribunal categorized the various acts and omissions giving rise to the dispute.<sup>40</sup> The tribunal turned to the contention of Maffezini that the project failed because SODIGA provided faulty advice regarding the cost of the project, which turned out to be significantly higher than originally planned. Based on a functional assessment, the tribunal found that SODIGA was not discharging any public functions in providing the information, for which reason this conduct could not be attributed to Spain.<sup>41</sup>

In his second claim, Maffezini argued that he was put under political pressure to go ahead with construction works even though the project was not yet approved by an environmental impact assessment. This caused additional costs at a later stage of the project. The tribunal found that Spain and SODIGA did nothing more than insist on the observance of the applicable law and that Maffezini took an independent decision to proceed with the construction before approval was granted.<sup>42</sup>

The third claim related to a transfer made from Maffezini's personal account to EAMSA as a loan, even though he did not consent to the loan. Spain denied the allegations on the grounds that Maffezini had consented to the loan, had authorized the transfer of funds and had mandated Luis Soto Baños, SODIGA's representative in EAMSA, to undertake these operations. Since Baños was for these purposes acting as the personal representative of Maffezini, Spain submitted that his acts could not be attributed to SODIGA.<sup>43</sup>

Based on the fact that Baños discussed the transfer of these funds with the President of SODIGA and that the latter authorized him to proceed as he thought best while a similar authorization was not sought from Maffezini, the tribunal found that Baños was not acting in this operation as the personal representative of Maffezini but as an official of SODIGA. Therefore, the tribunal concluded, it

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38. *Id.*, Award on the Merits, at 48-50.

39. *Id.* at para. 52.

40. *Id.* at para. 57.

41. *Id.* at paras. 58-64.

42. *Id.* at paras. 65-71.

43. *Id.* at paras. 72-73.

had to be asked whether that action was purely commercial in nature or whether it was performed in the exercise of SODIGA's public or government functions. Handling of the accounts of EAMSA as a participating company, managing its payments and finances and generally intervening on its behalf before the Spanish authorities without being paid for these services were in the tribunal's view all elements that responded to SODIGA's public nature and responsibility. In addition, the tribunal noted that the transfer was in fact an increase of the investment. A decision to increase the investment, taken not by Maffezini but by the entity entrusted by the state to promote the industrialization of Galicia, could not be considered a commercial activity. Rather, the tribunal found, it grew out of the public functions of SODIGA. Consequently, the tribunal held that the acts of SODIGA relating to the loan were attributable to Spain.<sup>44</sup>

The analysis on attribution conducted in *Maffezini* is particularly remarkable in two aspects. First, the tribunal correctly noted that the mere fact that SODIGA was a private corporation under Spanish law did not mean that it could not be considered a state organ under international law. This is in line with the Commentary to the ILC Articles, which emphasizes that according to article 4(2) of the ILC Articles, characterization as a state organ under international law does not depend on the status of the entity under domestic law.<sup>45</sup> Second, the examination conducted by the tribunal aptly shows that the functional test of article 5 of the ILC Articles must be applied on a case-by-case basis. Acts and omissions of a state-owned entity that is not a state organ cannot be automatically attributed to the state. Rather, every conduct for which the investor considers the state to be responsible has to be independently examined. Only if the tribunal finds this conduct to be governmental in nature can it be attributed to the state.<sup>46</sup>

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44. *Id.* at paras. 76-83.

45. ILC Articles with commentaries, *supra* note 20, at 42.

46. Another example for an analysis of whether a certain conduct of an entity is attributable to the state is *AMTO LLC v. Ukraine*, Decision, Arbitration No. 080/2005, paras. 101-02 (Arbitration Inst. of the Stockholm Chamber of Commerce, Mar. 26, 2008). In this case, the tribunal firstly determined that the state-owned entity Energoatom was not an organ of the Ukrainian state. Consequently, the tribunal noted that the conduct of Energoatom can only be attributed to the state where it was shown that Energoatom was exercising governmental authority or acted on the instructions of, or under the direction or control of, the state in carrying out the conduct. Most recently, *Bayindir Insaat Turizm Ticaret VE Sanay A.S. v. Islamic Republic of Pakistan*, Award, ICSID Case No. ARB/03/29, paras. 117-30 (Aug. 26, 2009) deserves favorable mention. Here, the tribunal systematically examined whether the public corporation National Highway Authority ("NHA") was a state organ, an instrumentality acting in the exercise of governmental powers or whether it was acting under the direction or control of the state. Due to the separate legal status of the NHA, the tribunal discarded the possibility of treating the NHA as a state organ under Article 4 of the ILC Articles. With regard to Article 5 of the ILC Articles, the tribunal firstly noted that it was not disputed that the NHA was generally empowered to exercise elements of governmental authority. It pointed rightly out, however, that the existence of these general powers was not sufficient in itself for Article 5 of the ILC Articles to apply. Attribution under that provision rather

*E. Piercing the Corporate Veil*

A special form of attribution which deserves to be mentioned for the purposes of this article is the principle of “piercing the corporate veil.” This principle’s viability in international law was acknowledged in the leading case *Barcelona Traction*<sup>47</sup> and was recently reaffirmed in *Tokios Tokelés v. Ukraine*.<sup>48</sup> The tribunal in *Tokios* noted that the International Court of Justice did not attempt to define the precise scope of conduct that might prompt a tribunal to pierce the corporate veil. However, since the tribunal was satisfied that the case did not present any conduct which constituted an abuse of legal personality, it did not need to clarify the requirements of this principle under international law in more detail.<sup>49</sup>

The basic difference between the principle of “piercing the corporate veil” and the rules of attribution as reflected in the ILC Articles is that under the former, the contract itself is attributed to the state, while under the latter, only the act which constitutes the breach of international law is attributed for the purpose of state responsibility.<sup>50</sup> What this means will be dealt with in detail in the next section.

## IV.

## BREACH OF CONTRACT MUST CONSTITUTE A VIOLATION OF INTERNATIONAL LAW

In order to hold a state responsible under international law, the breach of contract must constitute a violation of an international obligation. This section first explains why the violation of an international obligation is relevant both from a procedural and a substantive perspective. It then examines the legal grounds on which—and the circumstances under which—a contractual breach

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required in addition that the instrumentality acted in a sovereign capacity in that particular instance. Since the tribunal denied that the NHA was acting in exercise of governmental authority, it turned to Article 8 of the ILC Articles whose application it confirmed.

47. *Barcelona Traction, Light and Power Co. Ltd. (Second Phase) (Belgium v. Spain)*, 1970 I.C.J. 3 (Feb. 5).

48. *Tokios Tokelés v. Ukraine*, Decision on Jurisdiction, of Apr. 29, 2004, para. 54 ICSID Case No. ARB/02/18, 2005 (quoting *Barcelona Traction* at para. 56): “In [*Barcelona Traction*], the International Court of Justice (‘ICJ’) stated, ‘the process of lifting the veil, being an exceptional one admitted by municipal law in respect of an institution of its own making, is equally admissible to play a similar role in international law.’ In particular, the Court noted, ‘[t]he wealth of practice already accumulated on the subject in municipal law indicates that the veil is lifted, for instance, to prevent the misuse of the privileges of legal personality, as in certain cases of fraud or malfeasance, to protect third persons such as a creditor or purchaser, or to prevent the evasion of legal requirements or of obligations.’”

49. *Id.* at para. 56.

50. Richard Happ, *The Nykomb Case in the Light of Recent ICSID Jurisprudence*, in RIBEIRO, *supra* note 23, 315, at 324.

amounts to such violation.

*A. Twofold Relevance of Violation of International Obligation*

As with the assessment of whether the claimed conduct is attributable to the state, the determination of whether the conduct violated an international obligation has twofold relevance. First, the violation of a treaty provision is relevant with regard to the jurisdiction of ICSID. Second, it is also a necessary requirement to establish the responsibility of the state under international law.

As stipulated in article 25(1) ICSID Convention, ICSID jurisdiction depends on the written consent of both parties. In a dispute between an investor and a state-owned entity, the investor will typically rely on the dispute settlement clause of the applicable bilateral investment treaty (“BIT”) or another investment treaty. The treaty may contain either a narrow or wide dispute settlement clause. An example of a narrow clause is article 26(1) ECT which reads:

Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.

Article 26(4) ECT contains the written consent of the contracting states to ICSID jurisdiction in the event the investor chooses to submit the dispute there. Thus, ICSID has jurisdiction for claims raised by the investor based on the alleged breach of an obligation placed in Part III. Article 26(1) ECT and similar dispute settlement clauses do not allow for the submission of claims based on a breach of contract, unless the breach amounts to a violation of the treaty.<sup>51</sup> Under treaties with a narrow dispute clause, the investor must hence establish that the state-owned entity violated a treaty provision. Otherwise ICSID does not have jurisdiction to hear his claim. The treaty may, however, contain a wide dispute settlement clause which provides that “any” or “all” disputes between a state and a foreign investor can be submitted to ICSID. It is disputed whether such a clause allows for the submission of disputes relating to a breach of contract which do not amount to a breach of the treaty.<sup>52</sup>

The violation of a treaty provision is, however, not only relevant with regard to ICSID jurisdiction, it is also a necessary requirement to establish the responsibility of the state under international law. Article 1 and 2 of the ILC Articles reflect this principle:

*Article 1. Responsibility of a State for its internationally wrongful acts*

Every internationally wrongful act of a State entails the international responsibility of that State.

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51. *Id.* at 319.

52. *Id.* at 320.

*Article 2. Elements of an internationally wrongful act of a State*

There is an internationally wrongful act of a State when conduct consisting of an action or omission:

- (a) is attributable to the State under international law; and
- (b) constitutes a breach of an international obligation of the State.<sup>53</sup>

Hence, the violation of an international obligation is relevant both from a procedural and a substantive perspective. The question thus arises as to what extent the tribunal should rely on the investor's allegation that the contractual breach amounts to a treaty violation when determining its jurisdiction.

Arbitral tribunals have in fact already been confronted with this question. In *SGS v. Pakistan*, the tribunal applied a *prima facie* test according to which the tribunal relied on the characterization of the case by the investor as long as "the facts asserted by the Claimant are capable of being regarded as alleged breaches of the BIT."<sup>54</sup> In *SGS v. Philippines*, the tribunal used a slightly stricter variation of the *prima facie* test: "Provided the facts as alleged by the Claimant and as appearing from the initial pleadings fairly raise questions of breach of one or more provisions of the BIT, the Tribunal has jurisdiction to determine the claim."<sup>55</sup> Under the formulation of the *prima facie* test in *SGS v. Philippines*, the tribunal has jurisdiction if the facts presented by the investor "fairly raise questions of breach of one or more provisions of the BIT."<sup>56</sup>

*B. Attribution Under the ILC Articles is Limited to Conduct that Constitutes a Breach of International Law*

Occasionally, one can find language in case law which suggests that under the ILC Articles, already the conclusion of the contract will be attributed to the

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53. ILC Articles, arts. 1-2.

54. *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, Decision on Objections to Jurisdiction, ICSID Case No. ARB/01/13, paras. 144-45 (Aug. 6, 2003):

At this stage of the proceedings, the Tribunal has, as a practical matter, a limited ability to scrutinize the claims as formulated by the Claimant. Some cases suggest that the Tribunal need not uncritically accept those claims at face value, but we consider that if the facts asserted by the Claimant are capable of being regarded as alleged breaches of the BIT, consistently with the practice of ICSID tribunals, the Claimant should be able to have them considered on their merits. We conclude that, at this jurisdiction phase, it is for the Claimant to characterize the claims as it sees fit. We do not exclude the possibility that there may arise a situation where a tribunal may find it necessary at the very beginning to look behind the claimant's factual claims, but this is not such a case.

55. *SGS v. Philippines*, *supra* note 13, at para. 157 ("In accordance with the basic principle formulated in the Oil Platforms case [...], it is not enough for the Claimant to assert the existence of a dispute as to fair treatment or expropriation. The test for jurisdiction is an objective one and its resolution may require the definitive interpretation of the treaty provision which is relied on. On the other hand, as the Tribunal in *SGS v. Pakistan* stressed, it is for the Claimant to formulate its case. Provided the facts as alleged by the Claimant and as appearing from the initial pleadings fairly raise questions of breach of one or more provisions of the BIT, the Tribunal has jurisdiction to determine the claim.").

56. *Id.*

state.<sup>57</sup> Such wording is, however, imprecise since Articles 4, 5, and 8 of the ILC Articles do not provide general rules on attribution meaning that any act can be attributed to the state if the requirement of structure, function, or control is met. The scope of these provisions is, rather, limited to conduct which constitutes a violation of international law. Thus, the conclusion of a contract by a state-owned entity cannot be attributed to the state, even if the state-owned entity was empowered with governmental authority. What is attributable, however, is the breach of the contract if it amounts to a breach of an international obligation.

That the ILC Articles do not contain general rules of attribution is already suggested by their title which reads “Responsibility of States for Internationally Wrongful Acts” and the wording of article 2 of the ILC Articles. The Commentary on the ILC Articles further supports the interpretation that the principles on attribution are inseparably linked to conduct that is a violation of international law. When introducing the provisions on attribution, the Commentary states:

*The question of attribution of conduct to the State for the purposes of responsibility is to be distinguished from other international law processes by which particular organs are authorized to enter into commitments on behalf of the State. . . . Such rules have nothing to do with attribution for the purposes of State responsibility. In principle, the State’s responsibility is engaged by conduct incompatible with its international obligations, irrespective of the level of administration or government at which the conduct occurs. Thus, the rules concerning attribution set out in this chapter are formulated for this particular purpose, and not for other purposes for which it may be necessary to define the State or its Government.*<sup>58</sup>

The commentary makes clear that the provisions on attribution were drafted with the specific purpose to provide rules on attributing conduct which constitutes a breach of international law. In addition, legal scholars advocate that the ILC Articles should not be confused with rules on agency as they exist under private law. Evans, for example, notes that, with regard to the scope of the ILC Articles:

The rules of attribution specify the actors whose conduct may engage the responsibility of the State, generally or in specific circumstances. *It should be stressed that the issue here is one of responsibility for conduct allegedly in breach of existing international obligations of the State. It does not concern the question which officials can enter into those obligations in the first place.*<sup>59</sup>

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57. See, e.g., *Noble Ventures*, Award, *supra* note 17, at para. 68 (“And secondly, as already indicated above, there is the more specific question as to whether one can regard the Respondent as having entered into the SPA (as well as other contractual agreements which have allegedly been breached), breach of which could consequently, by reason of the umbrella clause, be regarded as a violation of the BIT.”)

58. ILC Articles with commentaries, *supra* note 20, at 39 (emphasis added and citations omitted).

59. MALCOLM EVANS, INTERNATIONAL LAW 460 (2d ed. 2006) (emphasis added).

Moreover, Happ has noted that the ILC Articles should not be used to attribute acts other than violations of international law:

Contrary to a recently voiced opinion, it is not possible to attribute a contract concluded by a sub-division or state-entity to the state by using the rules on state responsibility. The rules of attribution have been developed in the context of attributing acts to the state in order to determine whether those acts are in breach of international law. They cannot be applied *mutatis mutandis*. A clear distinction exists between the responsibility of a state for the conduct of an entity that violates international law (e.g. a breach of treaty) and the responsibility of a State for the conduct of an entity that breaches a municipal law contract.<sup>60</sup>

Article 7 of the ILC Articles illustrates quite well that the attribution regime under the ILC Articles does not fit to attribute acts such as the conclusion of contracts. According to this article, conduct of an entity empowered to exercise elements of governmental authority shall be considered as an act of the state, even if it exceeds its authorities or contravenes instructions. According to the Commentary, this provision applies even where the entity in question has manifestly exceeded its competence.<sup>61</sup>

While this provision makes perfect sense in connection with the attribution of wrongful conduct, it appears to be inappropriate when it has to be decided whether the conclusion of a contract can be attributed to the state. In the latter case, it rather seems to be decisive whether the investor was reasonably entitled to believe that the state-owned entity was empowered to act on behalf of the state, a question which must arguably be decided under the domestic law of the host state. In sum, the ILC Articles can only be used to attribute conduct which constitutes a breach of an international obligation. Consequently, the conclusion of a contract is not attributable to the state under the ILC Articles.

### *C. Circumstances Under Which the Breach of Contract May Amount to a Violation of an International Obligation*

Article 12 of the ILC Articles defines the breach of an international obligation as an act of a state which is not in conformity with what is required of it by that international obligation, regardless of its origin or character. The characterization of an act as internationally wrongful is made on the basis of international law, irrespective of how such act is characterized by municipal

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60. Happ, *supra* note 50, at 324 (citations omitted). A different position is arguably taken by Nick Gallus, *An Umbrella Just for Two? BIT Obligations Observance Clauses and the Parties to a Contract*, 24 *ARB. INT'L L.* 1, 157-70 (2008). Gallus accepts that “[p]rimarily, international law rules of attribution are traditionally applied to acts breaching an international law obligation.” *Id.* at 166. With regard to the umbrella clause, however, he seems to suggest that the ILC Articles should be applied to attribute both the undertaking of the obligation and the subsequent breach. *See id.* at 167: “To establish that a state breaches an obligations observance clause through the sub-state entity’s failure to observe its obligations, a claimant will therefore need to apply the rules in ILC Articles 4, 5 and 8 to both the act of entering the obligation and the act of breach.”

61. ILC Articles with commentaries, *supra* note 20, at 45.

law. An act can thus constitute a violation of an international obligation even though it is lawful under municipal legislation.<sup>62</sup>

Article 12 of the ILC Articles applies to all international obligations of a state. International obligations may be established by a customary rule of international law, by a treaty or by a general principle applicable within the international legal order.<sup>63</sup> For the purpose of this article, it is of interest whether there exists a general international obligation to observe contractual obligations. The Commentary to the ILC Articles takes the position that “. . . the breach by a State of a contract does not as such entail a breach of international law. Something further is required before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party.”<sup>64</sup>

As observed by Wälde, this opinion is in line with the general view according to which a mere breach of contract does not constitute a violation of international law.<sup>65</sup> It may, however, constitute a violation of an international obligation under certain conditions. Such conditions are, for instance, present if the non-observance of a contractual obligation constitutes a violation of the obligation to provide fair and equitable treatment of foreign investments or to observe obligations entered into by the state (the latter is often referred to as an “umbrella clause”). A contractual breach may also amount to an expropriation in which case compensation is owed. The following will examine when a breach of contract may constitute a violation of one of the aforementioned obligations or amount to an expropriation.

#### *D. Fair and Equitable Treatment*

Most BITs and other investment treaties provide for fair and equitable treatment of foreign investments. Article 1105(1) of the North American Free Trade Agreement of 1992 (“NAFTA”), for instance, stipulates that “[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”<sup>66</sup>

One aspect of the fair and equitable treatment provision is the obligation to

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62. ILC Articles with commentaries, *supra* note 20, at 36. *See also* Böckstiegel, *supra* note 23, at 263.

63. ILC Articles with commentaries, *supra* note 20, at 55. *See also* Hobér, *supra* note 17, at 562-63.

64. ILC Articles with commentaries, *supra* note 20, at 41 (citations omitted).

65. Thomas W. Wälde, *Contract Claims Under the Energy Charter Treaty's Umbrella Clause: Original Intentions Versus Emerging Jurisprudence*, in RIBEIRO, *supra* note 23, at 205, 209.

66. North American Free Trade Agreement of 1992 [hereinafter NAFTA], 32 ILM 289, 605 (1993), art. 1105(1).

comply with contractual obligations.<sup>67</sup> The scope of this obligation is however not quite clear. Some tribunals noted in more general language that the fair and equitable treatment provision extends to violation of contracts. In *Mondev v. USA*,<sup>68</sup> for instance, the tribunal remarked with regard to the argument that governments might not be subject to the same rules of contractual liability as are private parties, that “a governmental prerogative to violate investment contracts would appear to be inconsistent with the principles embodied in Article 1105 and with contemporary standards of national and international law concerning governmental liability for contractual performance.”<sup>69</sup> Also, the tribunals in *SGS v. Philippines*<sup>70</sup> and *Noble Ventures*<sup>71</sup> suggested that the fair and equitable treatment provision covers the breach of a contractual obligation.

Other tribunals limited the scope of the fair and equitable treatment provision to contractual breaches resulting out of the use of sovereign power or of a discriminatory treatment. In *Consortium RFCC v. Morocco*,<sup>72</sup> the tribunal held that an alleged contractual breach can only amount to a violation of the fair and equitable treatment provision if the breach is based on an activity beyond that of an ordinary contracting party.<sup>73</sup>

In *Waste Management v. Mexico*,<sup>74</sup> the tribunal noted that even the persistent non-payment of debts by a municipality would not equate a violation of article 1105 NAFTA, “provided that it does not amount to an outright and unjustified repudiation of the transaction and provided that some remedy is open to the creditor to address the problem.”<sup>75</sup> The tribunal continued to state that in the case at hand, the contractual failure to pay could be explained, albeit not excused, by the financial crisis and that there was no evidence that it was motivated by prejudice.

The tribunal in *Impregilo v. Pakistan* argued similarly as in *Consortium RFCC* when explaining under which circumstances a breach of contract amounted to a breach of an international obligation: “In order that the alleged breach of contract may constitute a violation of the BIT, it must be the result of behavior going beyond that which an ordinary contracting party could adopt.

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67. DOLZER & SCHREUER, *supra* note 32, at 140-41.

68. *Mondev International Ltd. v. United States of America*, Award of the Tribunal, ICSID Case No. ARB(AF)/99/2 (Oct. 11, 2002).

69. *Id.* at para. 134.

70. *SGS v. Philippines*, Decision of the Tribunal on Objections to Jurisdiction, *supra* note 13, at para. 162.

71. *Noble Ventures*, Award, *supra* note 17, at para. 182.

72. *Consortium R.F.C.C. v. Kingdom of Morocco*, Award of the Tribunal, ICSID Case No. ARB/00/6 (Dec. 22, 2003).

73. *Id.* at para. 51.

74. *Waste Management, Inc. v. United Mexican States (Number 2)*, Award of the Tribunal, ICSID Case No. ARB(AF)/00/3 (Apr. 30, 2004).

75. *Id.* at para. 115.

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.”<sup>76</sup> The tribunal went on to declare that the breach of the fair and equitable treatment provision required the use of “*puissance publique*.”<sup>77</sup>

Most recently, *Bayindir v. Pakistan* explicitly followed the approach of *RFCC, Waste Management and Impregilo* by stating that “the Claimant must establish a breach different in nature from a simple contract violation, in other words one which the State commits in the exercise of its sovereign power.”<sup>78</sup> The tribunal noted thereby that it was aware of the circumstance that the tribunals in *Mondev*, *Noble Ventures* and *SGS v. Philippines* have been less demanding.

Tribunals appear thus to agree that a breach of contract may amount to a violation of the fair and equitable treatment provision. There is, however, no uniformity yet on the question whether the latter will only be violated if the contractual breach is the result of the use of sovereign power or of a discriminatory behavior.<sup>79</sup>

#### E. Expropriation

It is generally accepted that expropriation may affect not only tangible property but also a broad range of intangible assets of economic value to the investor, such as contractual rights.<sup>80</sup> Whether expropriation, including indirect expropriation, extends to contractual rights, depends primarily on the wording of the investment treaty. For instance, in the ECT, the first sentence of article 13 reads as follows:

##### EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as “Expropriation”) except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.<sup>81</sup>

76. *Impregilo S.p.A. v. Islamic Republic of Pakistan*, Decision on Jurisdiction, ICSID Case No. ARB/03/3, para. 260 (Apr. 22, 2005) (citations omitted).

77. *Id.* at para. 266.

78. *Bayindir Insaat Turizm Ticaret VE Sanay A.S. v. Islamic Republic of Pakistan*, Award of the Tribunal, ICSID Case No. ARB/03/29, para. 180 (Aug. 27, 2009).

79. See also DOLZER & SCHREUER, *supra* note 32, at 142.

80. August Reinisch, *Expropriation*, in MUCHLINSKI, *supra* note 8, at 410. See also MATTHEW WEINIGER ET AL., INTERNATIONAL INVESTMENT ARBITRATION §§ 8.116 – 8.118 (2007).

81. Energy Charter Treaty of 1994 [hereinafter ECT], Dec. 17, 1994, 1994 O.J. (L 380) 13.

Investment is, in relevant parts, defined in article 1(6) ECT as:

(6) 'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

(a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;

(b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;

(c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;

(d) Intellectual Property;

(e) Returns;

(f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.<sup>82</sup>

Under the ECT, it is thus clear that contractual rights can be the object of expropriation. In addition to the protection provided in investment treaties, there is however a widespread understanding that intangible rights are also under customary international law protected from expropriation measures.<sup>83</sup>

If contractual rights are protected from expropriation, the question arises as how to differentiate between an ordinary breach of contract and a breach of contract which amounts to an expropriation. In a dispute about the amount owed under a contract, the tribunal in *SGS v. Philippines* took the position that refusal of payment of a debt did not itself constitute an expropriation.<sup>84</sup> In essence, the tribunal appeared to be of the opinion that the threshold for an expropriation was only met if the contract was breached by use of a sovereign act, such as a law or a decree, or if the investor could not seek remedy for the breach.

In *Waste Management II*,<sup>85</sup> the tribunal was confronted with the question whether "a persistent and serious breach of a contract by a State organ can constitute expropriation of the right in question, or at least conduct tantamount to expropriation of that right, for the purposes of Article 1110."<sup>86</sup> The tribunal

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82. ECT art. 1(6).

83. Reinisch, *supra* note 80, at 411.

84. *SGS v. Philippines*, *supra* note 13, at para. 161 ("In the Tribunal's view, on the material presented by the Claimant no case of expropriation has been raised. Whatever debt the Philippines may owe to SGS still exists; whatever right to interest for late payment SGS had it still has. There has been no law or decree enacted by the Philippines attempting to expropriate or annul the debt, nor any action tantamount to an expropriation. The Tribunal is assured that the limitation period for proceedings to recover the debt before the Philippine courts under Article 12 has not expired. A mere refusal to pay a debt is not an expropriation of property, at least where remedies exist in respect of such a refusal. A fortiori a refusal to pay is not an expropriation where there is an unresolved dispute as to the amount payable.")

85. *Waste Management*, *supra* note 74.

86. *Id.* at para. 165.

found that a distinction must be made between mere failure or refusal to comply with a contract and conduct which crosses the threshold of taking and expropriation.<sup>87</sup> The tribunal noted that “[n]on-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation.”<sup>88</sup> “Rather,” the tribunal found, “it is necessary to show an effective repudiation of the right, unredressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent.”<sup>89</sup> Finally, the tribunal concluded that “[a] failing enterprise is not expropriated just because debts are not paid or other contractual obligations are not fulfilled. The position may be different if the available legal avenues for redress are blocked or are evidently futile in the face of governmental intransigence.”<sup>90</sup> In sum, the tribunal seemed to hold that a contractual breach may only then amount to a violation of article 1110 NAFTA if the breach is based on a sovereign act, such as a legislative decree, or if the investor has no possibility to seek redress for the breach before a court.

The tribunal in *Azurix*<sup>91</sup> drew the similar conclusion that “contractual breaches by a State party or one of its instrumentalities would not normally constitute expropriation . . . a State or its instrumentalities may perform a contract badly, but this will not result in a breach of treaty provisions, ‘unless it be proved that the state or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign.’”<sup>92</sup>

As can be inferred from the cited case law, tribunals agree that a mere failure to comply with a contractual obligation does not constitute expropriation. However, in all three cases, tribunals shared the view that a breach of contract which was the result of use of sovereign power, such as a decree annulling the contractual rights, may amount to an expropriation. Both tribunals in *Waste Management II* and *SGS v. Philippines* furthermore suggested that an ordinary breach of contract may constitute an expropriation if the investor is unable to

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87. *Id.* at para. 174 (“The mere non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation. Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts, as is envisaged by the use of the term ‘measure’ in Article 1110(1). [...] [T]he normal response by an investor faced with a breach of contract by its governmental counter-party (the breach not taking the form of an exercise of governmental prerogative, such as a legislative decree) is to sue in the appropriate court to remedy the breach. It is only where such access is legally or practically foreclosed that the breach could amount to an definitive denial of the right (i.e., the effective taking of the chose in action) and the protection of Article 1110 be called into play.”).

88. *Id.* at para. 175.

89. *Id.* at para. 175.

90. *Id.* at para. 177.

91. *Azurix v. Argentine Republic*, Award, ICSID Case No. ARB/01/12 (July 14, 2006).

92. *Id.* at para. 315 (citing *Consortium R.F.C.C.*, *supra* note 73, at para. 65) (citations omitted).

seek redress before court.

Thus, if a state-owned entity breaches its contractual obligation by using methods unavailable to a regular contracting party, compensation may be owed under the expropriation clause in the investment treaty. It may be noted that the passage cited from *Azurix* explicitly mentions that the expropriation provision also finds application if a state instrumentality breaches its obligation in exercise of its governmental authority.

Compensation under the expropriation clause may also be owed if a state-owned entity merely engages in an ordinary breach of contract, but the investor is unable to seek redress before a court. In this scenario, however, the decisive conduct under international law is not the breach of contract but the denial of justice. Such conduct will be attributed to the state under article 4 and not 5 of the ILC Articles.

#### F. Umbrella Clause

A typical version of a contemporary umbrella clause is article 10(1) ECT: “Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”<sup>93</sup> For purposes of this analysis, the umbrella clause raises mainly two questions: first, do the ILC Articles find application to the umbrella clause, and second, which type of obligations does the umbrella clause cover.

##### 1. Applicability of the ILC Articles to the Umbrella Clause

In section III.C, the general applicability of the ILC Articles to investor-state disputes has been discussed. Here, the more specific issue shall be addressed of whether the ILC Articles can be used to determine the state’s responsibility under the umbrella clause for the breach of contract committed by one of its entities. The debate can be illustrated with the umbrella clause as formulated in the ECT which reads: “Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”<sup>94</sup> The relevant question here is whether the “it” in the umbrella clause only refers to the state itself or whether it also includes state-owned entities whose conduct is attributable under article 5 of the ILC Articles. This debate is aptly described as the “it”-problem in legal writing.<sup>95</sup>

Arbitral tribunals gave different answers to this question. In *Impregilo SpA v. Islamic Republic of Pakistan*, the arbitral tribunal was of the opinion that the international law rules of attribution are not applicable when an independent

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93. ECT art. 10(1).

94. ECT art. 10(1).

95. See Hobér, *supra* note 17, at 567-82.

entity breaches a municipal contract. The tribunal argued that “a clear distinction exists between the responsibility of a State for the conduct of an entity that violates international law (e.g., a breach of Treaty), and the responsibility of a State for the conduct of an entity that breaches a municipal law contract (i.e., Impregilo’s Contract Claims).”<sup>96</sup> According to the tribunal, the international law rules on state responsibility and attribution apply to the former, but not to the latter.<sup>97</sup>

A different approach was taken by the tribunal in *Noble Ventures*. The tribunal first established that based on article 5 of the ILC Articles, the acts of the Romanian state-owned entities allegedly in violation of the BIT between the United States and Romania were attributable to Romania.<sup>98</sup> The tribunal then continued to state that where acts of an entity are to be attributed to the state for the purpose of applying an umbrella clause, “breaches of a contract into which the State has entered are capable of constituting a breach of international law by virtue of the breach of the umbrella clause.”<sup>99</sup> The tribunal concluded that the agreements entered into by the state-owned entities were concluded on behalf of Romania and were therefore attributable to Romania for the purpose of the umbrella clause.<sup>100</sup> In contrast to the finding in *Impregilo*, the tribunal in *Noble Ventures* did apply the ILC Articles to determine whether the contracts concluded by the state-owned entities were covered by the umbrella clause.

A similar approach was taken in *Eureko*. In this case, the tribunal established in a first step that under the ILC Articles, the contract entered into by the Minister of the State Treasury was attributable to the Republic of Poland.<sup>101</sup> In a second step, the tribunal found that Poland breached its contractual obligations and thereby violated the umbrella clause.<sup>102</sup> It is thus clear that the tribunal applied the ILC Articles in order to assess the scope of the umbrella clause.<sup>103</sup>

In the recent case *AMTO v. Ukraine*<sup>104</sup>, the tribunal concluded that the state-owned entity was not a state organ<sup>105</sup> and that the relevant act, the non-payment of contractual debts, did not involve an exercise of sovereign

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96. *Impregilo*, *supra* note 76, at para. 210.

97. *Id.*

98. *Noble Ventures*, *supra* note 17, at paras. 70, 80.

99. *Id.* at para. 85.

100. *Id.* at para. 86.

101. The tribunal primarily relies on article 4 of the ILC Articles but mentions article 5 and 8 as well. *Eureko*, *supra* note 28, paras. 127-34.

102. *Id.* at paras. 244-60.

103. See Hobér, *supra* note 17, at 580.

104. *AMTO*, *supra* note 46.

105. *Id.* at para. 101.

authority<sup>106</sup> and was not made on the instructions of, or under the direction or control of Ukraine.<sup>107</sup> The non-payment of contractual debts was therefore not attributable to the state under the ILC Articles. When the tribunal thereafter turned to the alleged breach of the umbrella clause of the ECT, it could thus simply note that “in the present case the contractual obligations have been undertaken by a separate legal entity, and so the umbrella clause has no direct application.”<sup>108</sup> Since the tribunal found that the conduct in question could already as a general matter not be attributed to Ukraine, it did not have to address the question whether the “it” in the umbrella clause included state-owned entities whose conduct was attributable to the state under article 5 of the ILC Articles.

It is not self-evident whether the ILC Articles can be used to determine the state’s responsibility under the umbrella clause for the breach of contract committed by one of its entities. The umbrella clause imposes the duty on the state to observe obligations into which it has entered. As has been shown in section IV.B, the ILC Articles can only be used to attribute conduct which constitutes a breach of an international obligation. The conclusion of the contract itself, however, is not attributable. It could thus be argued that since the undertaking of the obligation cannot be attributed, the attribution of the subsequent breach becomes meaningless.<sup>109</sup> This line of argument would lead to the conclusion that the breach of contract entered into by a state-owned entity is not covered by the umbrella clause. Such reading is however not fully convincing since this rather formalistic approach ignores the rationale both of the umbrella clause and of the ILC Articles. As a result, such construction would allow the state to avoid its responsibility by simply delegating its power to private entities. This, however, is exactly what the ILC Articles seek to prevent.<sup>110</sup>

## 2. *Obligations Which are Covered by an Umbrella Clause*

In an investor-state dispute, the investor is likely to take the position that an umbrella clause transforms every contractual claim of an investor against the state to a treaty dispute. The respondent state, however, will typically advocate

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106. *Id.* at para. 107.

107. *Id.* at para 108.

108. *Id.* at para. 110.

109. *See* Gallus, *supra* note 60, at 165-67.

110. *See* Hobér, *supra* note 17, at 549, 582; *see also* Wälde, *supra* note 65, at 226 (arriving at the same conclusion: “It may well be that in contract law terms the Impregilo contract was not signed with the government of Pakistan, but with WAPDA. But if WAPDA’s conduct can be attributed to Pakistan – on lines that have been applied in *Maffezini v. Spain*, *Salini v. Morocco* (jurisdictional award), and *Nykomb v. Latvia*, - then there could be, on the basis of an umbrella clause, a assurance by Pakistan to respect that commitment.”).

a much narrower reading of the clause. The state is at least expected to argue that purely commercial contracts are not covered by the umbrella clause.<sup>111</sup>

Tribunals interpreted the umbrella clause differently. In *SGS v. Pakistan*,<sup>112</sup> the investor argued that the umbrella clause in BIT between Switzerland and Pakistan “says that each time you violate a provision of the contract . . . you also violate norms of international law, you violate the treaty by the same token”<sup>113</sup> and that it “elevate[s] breaches of contract as breaches of a treaty.”<sup>114</sup> The tribunal, however, construed the umbrella clause much narrower. It only found that the provision could imply a commitment to appropriately implement the obligation consumed towards the investor and that the provision might be violated if the state impeded the investor to prosecute its claims before an international arbitration tribunal or if the state refused to go to such arbitration at all.<sup>115</sup> This decision was widely criticized. Wälde, for instance, characterized such an interpretation as a soft-law, zero- effectiveness reading.<sup>116</sup>

A broader interpretation was given to the umbrella clause in the Swiss-Philippines BIT, article X(2), in *SGS v. Philippines*.<sup>117</sup> The tribunal found that “if commitments made by the State towards specific investments do involve binding obligations or commitments under the applicable law, it seems entirely consistent with the object and purpose of the BIT to hold that they are incorporated and brought within the framework of the BIT by Article X(2)”<sup>118</sup> and that “Article X(2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments.”<sup>119</sup> The tribunal was however criticized by some commentators for referring the investor for the contractual claims to the domestic courts of the Philippines because the investment agreement contained an exclusive choice of forum clause. A party, the tribunal reasoned, should not be allowed to rely on a contract as the basis of its claim when the contract itself refers that claim exclusively to another forum.<sup>120</sup>

111. Wälde, *supra* note 65, at 213-14.

112. *SGS v. Pakistan*, *supra* note 54.

113. *Id.* at para. 99.

114. *Id.*

115. *Id.* at para. 172.

116. Wälde, *supra* note 65, at 220; see also James Crawford, *Treaty and Contract in Investment Arbitration*, in 24 *ARBITRATION INT’L* 351, 367 (2008) (“The first [position] effectively deprives the umbrella clause of any content, contrary to the principle of *effet utile* and to the apparent intent of the drafters.”)

117. *SGS v. Philippines*, *supra* note 13.

118. *Id.* at para. 117.

119. *Id.* at para. 128.

120. *Id.* at para. 154. For critiques, see DOLZER & SCHREUER, *supra* note 32, at 156; and Wälde, *supra* note 65, at 221-22.

In *Eureko*,<sup>121</sup> the tribunal found that in light of the ordinary meaning, the context and the object and purpose of the umbrella clause in the BIT between the United States and Poland, article 3.5, every contractual obligation was protected:

The plain meaning—the ‘ordinary meaning’—of a provision prescribing that a State ‘shall observe any obligations it may have entered into ‘with regard to certain foreign investments is not obscure. The phrase, ‘shall observe’ is imperative and categorical. ‘Any’ obligations is capacious; it means not only obligations of a certain type, but ‘any’ – that is to say, all – obligations entered into with regard to investments of investors of the other Contracting Party. [. . .] The context of Article 3.5 is a Treaty whose object and purpose is ‘the encouragement and reciprocal protection of investment,’ a treaty which contains specific provisions designed to accomplish that end, of which Article 3.5 is one. It is a cardinal rule of the interpretation of the treaties that each and every operative clause of a treaty is to be interpreted as meaningful rather than meaningless. It is equally well established in the jurisprudence of international law, particularly that of the Permanent Court of Justice, that treaties, and hence their clauses, are to be interpreted so as to render them effective rather than ineffective.<sup>122</sup>

The tribunal in *Noble Ventures* rendered a decision on the meaning of the umbrella clause in the BIT between the United States and Romania, article II (2)(c), reading: “Each Party shall observe any obligation it may have entered into with regard to investments.” The tribunal first held that the wording of this provision was different from the clauses in *SGS v. Pakistan*, *SGS v. Philippines* and *Salini v. Jordan* for which reason article II (2)(c) had to be interpreted regardless of the other cases.<sup>123</sup> The tribunal continued to note that the wording<sup>124</sup> and the purpose<sup>125</sup> of article II (2)(c) supported the interpretation that article II (2)(c) referred to investment contracts. However, since the tribunal found that Romania was not in breach of the contract, it did not need to answer whether the umbrella clause covered every contractual breach and thus left the question open.<sup>126</sup>

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121. *Eureko*, *supra* note 27.

122. *Id.* at para. 246-48.

123. *Noble Ventures*, *supra* note 17, at para 50.

124. *Id.* at para. 51.

125. *Id.* at para. 52 (“An interpretation to the contrary would deprive the investor of any internationally secured legal remedy in respect of investment contracts that it has entered into with the host State. While it is not the purpose of investment treaties *per se* to remedy such problems, a clause that is readily capable of being interpreted in this way and which would otherwise be deprived of practical applicability is naturally to be understood as protecting investors also with regard to contracts with the host State generally in so far as the contract was entered into with regard to an investment.”).

126. *Id.* at para. 61 (“[I]t is unnecessary for the Tribunal to express any definitive conclusion as to whether therefore, despite the consequences of the exceptional nature of umbrella clauses, [...], Art. II(2)(c) of the BIT perfectly assimilates to breach of the BIT *any* breach by the host State of *any* contractual obligation as determined by its municipal law *or* whether the expression ‘any obligation’,

In *El Paso v. Argentina*,<sup>127</sup> the tribunal explicitly rejected an interpretation according to which every contractual breach would be protected by the umbrella clause. The tribunal rather was of the opinion that a distinction must be made between the state acting as a merchant and the state acting as a sovereign. It concluded that the umbrella clause in the BIT between the United States and Argentina which prescribed that “[e]ach Party shall observe any obligations it may have entered into with regard to investments” “will not extend the Treaty protection for breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections such contractually agreed by the State as a sovereign—such as a stabilization clause—inserted in an investment agreement.”<sup>128</sup> It comes as little surprise that the tribunal in *Pan American v. Argentina* rendered an almost identical decision on the scope of the umbrella clause in the BIT between the United States and Argentina since the tribunal comprised two arbitrators who had acted already as arbitrators in *El Paso* and since the decision was rendered only a few months later.<sup>129</sup>

The approach taken by the tribunals in *El Paso* and *Pan American* was not followed in *Siemens v. Argentina*. The umbrella clause in the BIT between Germany and Argentina, article 7(2), read “[e]ach Contracting Party shall observe any other obligation it has assumed with regard to investments by nationals or companies of the other Contracting Party in its territory.” The tribunal considered that article 7(2) “has the meaning that its terms express, namely, that failure to meet obligations undertaken by one of the Treaty parties in respect to any particular investment is converted by this clause into a breach of the Treaty.”<sup>130</sup> It continued that no distinctions should be made with regard to the nature of the investment agreement.<sup>131</sup>

As can be seen from the collection of decisions on the umbrella clause,

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despite its apparent breadth, must be understood to be subject to some limitation in the light of the nature and objects of the BIT.”)

127. *El Paso Energy Int’l Co. (U.S.) v. Argentine Republic*, Decision on Jurisdiction, ICSID Case No. ARB/03/15, para. 52 (Apr. 27, 2006).

128. *Id.* at para. 81.

129. *Pan Am. Energy LLC (U.S.) v. Argentine Republic*, Decision on Preliminary Objections, ICSID Case No. ARB/03/13, para. 109 (July 27, 2006).

130. *Siemens AG v. Argentina*, Award, ICSID Case No. ARB/02/8, para. 204 (Feb. 6, 2007).

131. *Id.* at para. 206 (“The Tribunal does not subscribe to the view of the Respondent that investment agreements should be distinguished from concession agreements of an administrative nature. Such distinction has no basis in Article 7(2) of the Treaty which refers to ‘any obligations’, or in the definition of ‘investment’ in the Treaty. Any agreement related to an investment that qualifies as such under the Treaty would be part of the obligations covered under the umbrella clause. The Tribunal does not find significant, for purposes of the ordinary meaning of this clause, that it does not refer to ‘specific’ investments. The term ‘investment’ in the sense of the Treaty, linked as it is to ‘any obligations’, would cover any binding commitment entered into by Argentina in respect of such investment.”)

tribunals have given the umbrella clause a wide range of meaning. On one end of the spectrum is the construction under which the provision is practically without any practical effect, as in *SGS v. Pakistan*. On the other end is the interpretation according to which every breach of a contractual obligation amounts to a violation of the umbrella clause, as in *Eureko*. The cases in between all have in common that the tribunals agreed that the umbrella clause will protect at least certain contractual breaches. While in *Noble Ventures* and *SGS v. Philippines* the tribunals did not spell out where exactly the line should be drawn, if at all, the tribunals in *El Paso* and *Pan American* held that only contracts in which the state acted as a sovereign will fall under the protection of the umbrella clause.

The diversity of opinions can only partially be explained with the different wording of the respective umbrella clause.<sup>132</sup> The tribunals which gave the umbrella clause a more restrictive meaning were mainly motivated by the concern that a far-reaching interpretation would transform even the most minor contract claim into a treaty claim<sup>133</sup> and would render other provisions such as the “fair and equitable treatment” or “full protection and security” clause useless.<sup>134</sup> On the other hand, the tribunals which gave the umbrella clause a broader meaning basically countered these arguments by stating that the umbrella clause “means what i[t] says.”<sup>135</sup>

If conduct can be attributed to the state under the functional test of article 5 of the ILC Articles, the threshold established in *El Paso* and *Pan American* according to which only contracts with a sovereign character are covered by the umbrella clause becomes redundant. It is difficult to imagine how a tribunal could find that the state-owned entity acted with governmental authority in its role as a contractual partner to an investment agreement, and then deny that the contract is of governmental nature. Wälde thus rightly points out that “the rules and indicators used to attribute the conduct of such ‘entities’ to the state are analogous—possibly identical—to the indicators to distinguish mainly commercial from significantly governmental disputes.”<sup>136</sup> The relevant question thus only becomes whether one agrees with the tribunal in *SGS v. Pakistan* that the umbrella clause is basically a “soft law” provision. Currently,

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132. The tribunals in *El Paso* and *Pan American* in fact rejected the argument that umbrella clauses should be interpreted differently based on variations of their drafting: “This tribunal is not convinced that the clauses analysed so far really should receive different interpretations.” *El Paso Energy*, *supra* note 127, at para. 70; *Pan American Energy*, *supra* note 129, at para. 99.

133. *El Paso Energy*, *supra* note 127, at para. 82; *Pan Am. Energy*, *supra* note 129, at para. 110.

134. *El Paso Energy*, *supra* note 127, at para. 76; *Pan Am. Energy*, *supra* note 129, at para. 105.

135. *SGS v. Philippines*, *supra* note 13, at para. 119. See also *Siemens v. Argentina*, *supra* note 130, at para. 204, and DOLZER & SCHREUER, *supra* note 32, at 161.

136. Wälde, *supra* note 65, at 229.

this interpretation appears to be quite isolated.

## V.

### RESPONSIBILITY UNDER THE ECT

Until now, general observations have been made with regard to the responsibility of the state for the breach of contracts entered into by their entities. These insights are insofar very valuable since most investment treaties share the same basic principles.<sup>137</sup> However, investment treaties are not identical and may vary quite substantially with regard to the formulations they employ. Thus, each case must be decided separately based on the applicable investment treaty. This may well be illustrated with the ECT, arguably the most important legal instrument governing international energy markets. The rest of this section will examine the responsibility of a state for contractual breaches of its entities under the regime of the ECT.

The ECT contains all three investment protection provisions mentioned in section IV: Article 10(1) ECT includes both the obligation to provide fair and equitable treatment and the umbrella clause and article 13 ECT provides protection from expropriation. For the purpose of this analysis, article 22 ECT in general and article 22(1) ECT in particular deserve special attention. Article 22 ECT is placed in Part IV of the ECT and has as its heading “State and Privileged Enterprises”; its first paragraph reads as follows:

Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty.<sup>138</sup>

When assessing state liability under international law, article 26(1) ECT must also be taken into consideration. This provision stipulates:

Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.<sup>139</sup>

When an investor sues a state for the breach of contract entered into by a state-owned entity, two specific questions are likely to arise under the ECT: first, the relation between article 22(1) ECT and article 26 ECT, and second, the relation between article 22(1) ECT and the ILC Articles.

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137. See WEINIGER ET AL., *supra* note 80, at para 2.05.

138. ECT art. 22(1).

139. ECT art. 26(1).

A. *Relation Between Article 22(1) ECT and Article 26 ECT*

An investor who claims that a state-owned entity breached a contractual obligation might base its claim against the state amongst others on article 22(1) ECT. The respondent state could, however, counter that the investor is not entitled to bring claim under article 22(1) ECT since article 26 ECT limits the jurisdiction of the tribunal to alleged breaches of an obligation under Part III of the ECT.

The relation between those two provisions was brought up in *Nykomb v. Latvia*.<sup>140</sup> The investor asserted that the alleged non-compliance of a contractual obligation by a state-owned entity was, inter alia, in breach of the umbrella clause (article 10(1) last sentence ECT) and the obligation to provide fair and equitable treatment (article 10(1) ECT) and constituted measures having an effect equivalent to expropriation (article 13 ECT). The investor reasoned that the failure to comply with the contract had to be attributed to the state under the ILC Articles. However, the investor also relied on article 22 ECT:

In addition [the attribution] is also operated by operation of Art. 22 (1, 3 and 4) of the Treaty. We believe Art. 22 to be a special attribution norm for the primary obligations contained in part III of the Treaty, but whatever the legal argument about this, customary international law rules are fully sufficient for attribution and Art. 22 (1, 3 and 4) merely reinforce, by direct effect or by an indirect interpretative support, the attribution. Using a very old and in civil law established concept, Art 22 is clearly ‘accessory’ (*‘akzessorisch’*, *‘accessorisk’*), to the ‘primary’ obligations in Part III of the Treaty.<sup>141</sup>

The respondent state, on the other hand, advocated a restrictive reading of article 22(1) ECT by referring to the explicit limitation of the arbitration clause in article 26 ECT to alleged breaches of an obligation under Part III. The tribunal took the following position:

Article 26 further requires that the claims must be based on alleged breaches of the Republic’s obligations under Part III of the Treaty.

As summarized above, the Claimant alleges that all its claims against the Republic are based on breaches of provisions in Articles 10 and 13, which are contained in Part III of the Treaty.

The Claimant has also referred to parts of Article 22. The Respondent has objected to the Tribunal’s jurisdiction on the ground that Article 22 is placed in Part IV of the Treaty. The Arbitral Tribunal notes, however, that the Claimant has stated that the provisions Article 22 referred to do not give rise to any separate claim, but are rather invoked as provisions which clarify the scope and contents of other treaty provisions, among them the provisions in Part III that the Claimant relies on as bases for its claims. The Tribunal finds that the interpretation and application of the relevant Articles of the Treaty, Articles 10 and 13, are best considered under the merits part of this award, and that the references to Article

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140. *Nykomb Synergetics Technology Holding AB v. Latvia*, Award (Arbitration Inst. of the Stockholm Chamber of Commerce, Dec. 16, 2003).

141. *Id.* at para 5.

22 cannot as such be dismissed as inadmissible in the form the references are relied on.<sup>142</sup>

In the merits part, the tribunal concluded that “in the circumstances of this case, the Republic must be considered responsible for [the state-owned entity’s] actions under the rules of attribution in international law. [. . .] The Tribunal will add that for this finding it is not necessary to rely on the supplemental rule in Article 22(1) of the Treaty contended by the Claimant (see section IV.C.1 below).”<sup>143</sup> The tribunal made thus clear that it based its decision to attribute the conduct of the state-owned entity to Latvia on customary international law and not on article 22(1) ECT. For this reason, the tribunal did not need to clarify the relation between article 22(1) ECT and 26 ECT.

Hobér criticized that the tribunal “could have made a trailblazing decision on Article 22(1) and its role for Article 26(1),” but that it “preferred, however, to avoid such a thorny dispute.”<sup>144</sup> Some conclusions, however, can be drawn from the decision. The investor did not claim an independent breach of article 22(1) ECT. Based on this argument, the tribunal affirmed its jurisdiction (“the references to Article 22 cannot as such be dismissed as inadmissible in the form the references are relied on”). It can therefore be noted that while the tribunal might have declined its jurisdiction if the investor had raised a claim for an independent breach of article 22(1) ECT, it appears that it regarded itself, as a general matter, competent to decide a claim in which article 22(1) ECT was solely used to “clarify the scope and contents of other treaty provisions.” That the tribunal did ultimately not rest its decision on article 22(1) ECT does not change the fact that the tribunal did not dismiss the claim based on procedural considerations.

This finding is convincing. Given the wording of article 26(1) ECT, a tribunal indeed lacks jurisdiction to hear a claim based on an independent breach of article 22(1) ECT.<sup>145</sup> The tribunal should however affirm its jurisdiction if the investor only relies on article 22(1) ECT in terms of an attribution norm. Such reference to article 22(1) ECT does not impose a new obligation on the state but rather clarifies the scope of the primary obligations contained in Part III. The precise meaning of article 22(1) ECT will be looked at in the next section.

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142. *Id.* at para 8.

143. *Id.* at para 31.

144. Hobér, *supra* note 17, at 283.

145. It may however be noted that in *Petrobart Limited v. Kyrgyz Republic*, Award, Arb. No. 126/2003, at para. 29 (Arbitration Inst. of the Stockholm Chamber of Commerce, March 29, 2005), the tribunal did not dismiss an independent claim for breach of article 22 ECT based on procedural but on substantive grounds.

*B. Relation Between Article 22(1) and the ILC Articles*

The ILC Articles have a residual character.<sup>146</sup> This is made clear in article 55 of the ILC Articles:

*Article 55. Lex specialis*

These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.<sup>147</sup>

Article 55 of the ILC Articles can play an important role when the responsibility of the state for acts of state-owned entities is assessed. In *United Parcel Service of America v. Government of Canada*,<sup>148</sup> the tribunal concluded that article 1502(3)(a)<sup>149</sup> and 1503(2)<sup>150</sup> NAFTA, provisions which address the responsibility of the state for monopolies and state-owned entities, provided for a *lex specialis* regime which precluded the application of article 4 or 5 of the ILC Articles.<sup>151</sup>

An investor could assert that article 22(1) ECT is a special norm dealing with the responsibility of the state for the conduct of its entities whose scope is wider than that of article 5 or 8 of the ILC Articles. The investor could support his argumentation by referring to the broad wording of article 22(1) ECT which speaks of “any” state enterprise and not, for instance, of an “enterprise empowered with governmental authority” as does article 5 of the ILC Articles. In order to strengthen its argument, the investor could compare the wording of this provision with the formulation of article 22(3) ECT which limits the state’s

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146. ILC Articles with commentaries, *supra* note 20, at 139.

147. ILC Articles, art. 55.

148. *United Parcel Service v. Canada*, NAFTA, Award on the Merits (UNCITRAL 2007).

149. Article 1502(3)(a) NAFTA reads,

[e]ach Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately owned monopoly that it designates and any government monopoly that it maintains or designates:

(a) acts in a manner that is not inconsistent with the Party’s obligations under this Agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges...

150. Article 1503(2) NAFTA stipulates,

[e]ach Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party’s obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

151. *Id.* at paras. 57-63.

responsibility to entities “with regulatory, administrative or other governmental authority” or with the formulation provided in article 1503(2) NAFTA, which includes the passage “wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it.” Moreover, the investor could point out that article 22(1) ECT only refers to state enterprises which the state “maintains or establishes”; the provision does not require that the state enterprise acts “on the instructions of, or under the direct control of” the state as does article 8 of the ILC Articles. Hence, the argument would continue, an investor may bring a claim if a state-owned entity breaches a contractual obligation,<sup>152</sup> provided that such entity is engaged in the sale or provision of goods or services, and irrespective of whether the entity is empowered with governmental authority or acted under the control of the state.

The respondent state might agree with the argument outlined above, insofar as it might also submit that article 22(1) ECT is a special norm which displaces article 5 or 8 of the ILC Articles. However, since article 22(1) ECT was not placed in Part III of the ECT, so the argument continues, the tribunal would have no jurisdiction to hear such a claim. The respondent could therefore argue that under the regime of the ECT, the investor has no actionable claim against the state for an act committed by a state-owned entity that is inconsistent with the ECT. Such line of argument would combine the *lex specialis* reading of article 22(1) ECT with the procedural objection raised by Latvia in *Nykomb*. In the alternative, the state could argue that article 22(1) ECT reduces the responsibility of the state from a “full attribution-standard,” as under the displaced ILC Articles, to a “due diligence-standard” because this provision only requires the state to ensure the compliance of its entities.

In *Nykomb*, the tribunal attributed the acts of the Latvian state-owned entity under “the rules of attribution in international law” and added that for its finding, it was not necessary “to rely on the supplemental rule in Article 22(1) of the Treaty contended by the Claimant.”<sup>153</sup> Based on this reasoning, it can be concluded that the tribunal in *Nykomb* clearly did not regard article 22 ECT as a *lex specialis* which displaces the general rules of attribution as reflected in the ILC Articles.

In *Petrobart*, the tribunal applied 22(1) ECT without making any reference to the attribution provisions in the ILC Articles.<sup>154</sup> The tribunal did not inquire

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152. Such claim could, for instance, be based on the breach of the umbrella clause in conjunction with article 22(1) ECT.

153. *Nykomb*, *supra* note 140, at para. 4.2.

154. *Petrobart*, *supra* note 145, para. 77 (“According to Article 22(1) of the Treaty, each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party’s obligations under Part III of the Treaty. KGM was a state enterprise maintained and established by the Kyrgyz Republic. Article 22(1) thus placed certain obligations on the Republic in regard to KGM’s conduct of its business activities. However, the

whether KGM, the state-owned entity, was empowered with governmental authority, but rather appears to have solely relied on the “maintained or established” precondition provided for in article 22(1) ECT when finding that the Kyrgyz Republic bore responsibility for the acts of KGM. It could, however, be argued that the tribunal might have forgone such inquiry because it dismissed the claim anyway. Furthermore, the governmental nature of KGM seemed rather obvious since it was “created for the purpose of rationalization of the use of the state-owned infrastructure for oil, as well as natural and liquid gas product supply.”<sup>155</sup>

In *AMTO*, the tribunal applied both the international principles as reflected in the ILC Articles<sup>156</sup> and article 22(1) ECT<sup>157</sup> when assessing whether Ukraine was responsible for the conduct of a state-owned entity. The tribunal did therefore obviously not consider article 22(1) ECT as a special norm which displaces the ILC Articles, but rather regarded article 22(1) ECT as an additional ground on which state responsibility for the conduct of a state-owned entity can be established. The tribunal gave article 22(1) ECT (in conjunction with the umbrella clause) however a quite narrow meaning:

The Tribunal considers that Article 22 does not go so far as to impose liability on the State in the event that a state-owned legal entity does not discharge its contractual obligations in relation to an ‘Investment’, as in a subsidiary of the foreign investor. Rather, it imposes on the state a general obligation to ‘ensure’ that state-owned entities conduct activities which, in general terms of governance, management and organization, make them capable of observing the obligations specified under Part III of the ECT. It does not constitute an obligation of the state to assume liability for any failing of a state-owned legal entity to discharge a commercial debt in a given instance.<sup>158</sup>

Under *AMTO*, a state can thus become responsible for the conduct of a state-owned entity when the preconditions of article 4, 5 or 8 of the ILC Articles are met and, as an alternative legal ground, when the state fails to ensure that the entities it maintains or establishes are provided with a structure (“governance, management and organization”) which enables them to fulfill the obligations listed in Part III of the ECT.

Neither in *Nykomb* nor in *AMTO* did the tribunal find that article 22(1) ECT has to be construed as a *lex specialis* which displaces the ILC Articles. The tribunal in *Petrobart* only assessed the state’s responsibility under article 22(1) ECT and did not address the attribution provisions in the ILC Articles. Given the lack of any discussion on the relation between the ILC Articles and

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Arbitral Tribunal cannot find it established that the Republic failed to ensure that KGM conducted its business in a manner consistent with Part III of the Treaty.”)

155. *Id.* at para. 5.

156. *AMTO*, *supra* note 46, at paras. 101-102.

157. *Id.* at paras. 111-112.

158. *Id.* at para. 112.

article 22(1) ECT, it seems reasonable, however, to conclude that the *Petrobart* tribunal did not intend to suggest that the latter provision supersedes the ILC Articles.

It would not be convincing to construe article 22(1) ECT as a special norm which displaces the ILC Articles. The ILC Articles strike a delicate balance between opposing interests which should not be easily disturbed. To read that article 22(1) ECT imposes responsibility on the state for the violation of obligations listed in Part III of the ECT of every entity it maintains or establishes (provided that it engages in the sale or provision of goods and services), would give this provision a very powerful meaning which is not sufficiently reflected in its wording.<sup>159</sup> The fact that the provision is placed under the heading “Miscellaneous Provisions” in Part IV further points to a more restrictive reading of article 22(1) ECT since it appears unlikely that a provision with such impact would be placed under such ambiguous and unspecific heading. A narrower reading of article 22(1) ECT is also supported by the conclusion drawn in section V.A: If article 22(1) ECT is not understood as imposing an independent obligation on the state but rather as merely clarifying the scope of the primary obligations placed in Part III, then it appears more appropriate to construe its scope reluctantly.

It is however also not convincing to read article 22(1) ECT as replacing the “full attribution-standard” of the ILC Articles with a mere “due diligence-standard” based on the argument that the state only has to ensure compliance. Such construction of the term “shall ensure” appears doubtful. In treaty language, “shall” usually refers to a hard-law obligation in contrast to the soft-law term “should.”<sup>160</sup> Furthermore, the verb “to ensure” rather suggests that a certain conduct is guaranteed.<sup>161</sup> Finally, it may be noted that in view of the purpose of the ECT as an instrument of investment protection, it is not plausible to assume that article 22(1) ECT was introduced with the intention to limit the rights of investors.<sup>162</sup> Hence, in light of the rather ambiguous language of the

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159. It can, however, be noted that the effect of such a wide construction would be limited by a restrictive interpretation of the international obligations. If, for instance, the tribunal were to find that only obligations of a governmental nature are covered by the umbrella clause, the state could obviously not be held responsible for contractual breaches of a purely commercial state-owned entity.

160. Thomas Wälde, *Legal Opinion*, in 2 TRANSNAT'L DISP. MGMT. 5, para. 87, available at <http://ita.law.uvic.ca/documents/waeldeopinion.pdf>.

161. *Id.*

162. *See id.* at para. 96. A similar argument, though under the regime of NAFTA, was brought forward by the investor in UPS. In its Reply, it argued that “[in] recognition of the unique dangers posed by monopolies and state enterprises to the purposes of NAFTA, Chapter 15 reinforces state responsibility under Chapter 11,” and pointed out that “Canada essentially argues that the Chapter 15 provisions, which are designed to enhance state responsibility, actually reduce that responsibility.” *UPS v. Canada*, *supra* note 148, Investor’s Reply (Merits Phase), Public Version, 15 August 2005, paras. 476, 477.

provision and the overall goal of the ECT, it is unlikely to assume that article 22(1) ECT is meant to replace international customary law as reflected in the ILC Articles.<sup>163</sup>

For the reasons stated above, it appears more convincing to read article 22(1) ECT as merely underlining the responsibility of the state for the conduct of its entities in accordance with the existing international customary law. This view seems to be shared by eminent legal writers. Wälde, for instance, thoroughly analyzed the meaning of article 22(1) ECT in a legal opinion rendered in *Nykomb*:

The conclusion is therefore that the Treaty does not materially modify established principles of state responsibility for state enterprises, but merely clarifies and confirms that a state can not [sic] escape from liability if it delegates the problematic conduct to a semi-autonomous entity it controls and owns. The Treaty's solution supports a more extensive view of state responsibility for state enterprises rather than a more restrictive view – as is consistent with the overall approach of the Treaty. The principal obligation is contained in part III. Art. 22 (1) makes explicit reference to this—limitative—list of disciplines. Art. 22 is merely a clarificatory attribution provision.<sup>164</sup>

Böckstiegel also seems to agree that article 22(1) ECT does not displace the ILC Articles, but rather, “particularly for the subject of state responsibility, customary international law has always been a primary source of substantive law, and this will continue to be so for the ECT.”<sup>165</sup> Böckstiegel supports his statement by referring to article 26(6) ECT which provides that a tribunal “shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.”<sup>166</sup>

The tribunal's finding in *AMTO* is in line with the conclusion reached here insofar as it did not construe article 22(1) ECT as a norm replacing the ILC Articles, but the tribunal went a step further by interpreting article 22(1) ECT as an additional ground on which responsibility of the state can be established based on the conduct of a state-owned entity. Under the interpretation of the tribunal, this additional legal basis has, however, a rather limited scope since article 22(1) ECT merely “imposes on the state a general obligation to ‘ensure’ that state-owned entities conduct activities which, in general terms of governance, management and organization, make them capable of observing the obligations specified under Part III of the ECT.”<sup>167</sup> Such construction

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163. See also the convincing position of the investor in *UPS*, according to which “[i]n the absence of any expressly stated intention of the Parties to limit their international responsibility, such a limitation should not be presumed” *UPS v. Canada*, Investor's Reply (Merits Phase), *supra* note 148, at para. 478.

164. *Id.* at para. 93.

165. Böckstiegel, *supra* note 24, at 259.

166. *Id.*

167. *AMTO*, *supra* note 46, at para. 112.

resembles article 1503(2) NAFTA where the responsibility of the state for any state enterprise that it maintains or establishes is limited to “regulatory control, administrative supervision or the application of other measures.” Despite the rather narrow scope of article 22(1) ECT under such construction, one might still ask whether such interpretation would not give the provision an independent meaning for which the arbitral tribunal had no jurisdiction in view of article 26(1) ECT.

## VI. CONCLUSION

In order to establish the responsibility of a state for the breach of contract committed by one of its entities, two preconditions must be fulfilled. As a first precondition, a state can only be held responsible if the state-owned entity was empowered with governmental authority and if it acted in such capacity when breaching the contract.<sup>168</sup> If an entity exercises both governmental and commercial functions, such as SODIGA in *Maffezini*, it must thus be analyzed in which role it concluded and performed the agreement. Only if it acted in its sovereign capacity can the breach be attributed to the state. As a second precondition, the contractual breach must amount to a violation of international law. Such a violation occurs, for instance, if the breach constitutes a violation of the obligation to provide fair and equitable treatment, to observe obligations entered into by the state or if the breach amounts to an expropriation.

Tribunals seem to agree that a breach of contract may amount to a violation of the fair and equitable treatment provision. It is however not quite clear whether this obligation will only be violated if the breach of contract is the result of the use of sovereign power or of a discriminatory behavior (see *Consortium RFCC, Waste Management, Impregilo*). There is case law which suggests that the threshold might be lower (see *Mondev, SGS v. Philippines, Noble Ventures*).

Even less uniformity exists on the question under which circumstances the umbrella clause will be violated (compare, for instance, the discrepancy between *SGS v. Pakistan* and *Eureko*). It is submitted in this article that if it can be established that the entity acted in governmental capacity when it performed the contract and that it failed to honor its contractual obligation, the state can be held responsible for a violation of the umbrella clause.

Tribunals agree however that the mere failure to comply with the contract does not constitute an expropriation. It appears that the state’s responsibility under the expropriation clause will only arise if a state-owned entity breaches its

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168. Note that this article focuses on article 5 of the ILC Articles. Conduct of a state-owned entity may, alternatively, be attributed if the state-owned entity constitutes a state organ in the sense of article 4 of the ILC Articles or if the entity acted on the instructions of, or under the direction or control of, the state in the sense of article 8 of the ILC Articles.

contractual obligation by using methods unavailable to a regular contracting party or if the investor is unable to seek redress before a court (see *SGS v. Philippines, Waste Management II, Azurix*).

Investment treaties may include provisions which explicitly address the responsibility of the state for conduct of its entities. Based on observations made with regard to the ECT, it is suggested here that if these provisions do not employ clear and unambiguous language, they should not be construed as displacing the international customary law on attribution as reflected in the ILC Articles.