

# CONTRACTING WITH THE STATE

## COMMON PITFALLS

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## A. Political Risks and Adverse Treatment

- Generally determined by uncertainty over the actions of governments and political institutions.
  
- **Political Risks**
  - Breach of contract by governments
  - Restrictions on currency transfer and convertibility
  - Expropriation
  - Political violence (war, civil disturbance and terrorism)
  - Non-honoring of government guarantees
  - Adverse regulatory changes
  
- *“Breach of contract is the political risk of most concern to respondents, both this year [2009] and over the medium term.”*

(Multilateral Investment Guarantee Agency – World Bank Group,  
Economist Intelligence Unit, Political Risk Survey 2009)

## B. Legal Implications of Contracting with the State: Treaty Claims v. Contract Claims

- (1) Investment treaty arbitration and jurisdiction over contract claims – are international tribunals competent to deal with contract claims?
- (2) Contracts concluded with State subdivisions/agencies and State-owned companies – are the acts and conduct of such distinct entities attributable to the State?
- (3) Domestic forum selection – by contractually agreeing to the choice of a domestic forum is an investor waiving the right to go to international arbitration granted by a BIT?
- (4) Impact of *litis pendens* and “fork-in-the-road” clauses

## (1) Investment Treaty Arbitration and Jurisdiction over Contract Claims (1/2)

- Arbitral tribunals have been consistent in recognizing that a breach of contract and a breach of an applicable international investment treaty constitute separate causes of action.
- 3 general contexts in which an arbitral tribunal may deal with claims based on an alleged breach of contract:
  - (A) Claimed breach of contract amounts to a breach of the international investment agreement – host country violates obligations included in the international investment treaty (e.g. fair and equitable treatment, expropriation, etc.).

## (1) Investment Treaty Arbitration and Jurisdiction over Contract Claims (2/2)

(B) Only a breach of contract is claimed – different positions taken by arbitral tribunals:

- a) recognizing jurisdiction: when a BIT provides for investor / State arbitration for all investment disputes – *Salini v. Morocco, ad-hoc Committee in Vivendi 1, SGS v. Philippines*.
- b) denying jurisdiction – *SGS v. Pakistan, Consorzio Groupement L.E.S.I.-DIPENTA v. Algeria*.

(C) The international investment agreement includes an “*umbrella clause*”.

Example of an “umbrella clause”: “*Each Party shall observe any obligation it may have entered with regard to investments*” [US-Romania BIT, Art. II (2) (c)]

## (2) Contracts concluded with State Subdivisions / Agencies and State-owned Companies

- **Conduct of State subdivision/agency/State-owned company should be attributable to the State** (*2001 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries, as adopted by the International Law Commission*):
  - (i) As being an organ of the state (Art. 4 of ILC Draft Articles – the structural test)
  - (ii) (ii) As being an entity empowered by the law of that State to exercise elements of the governmental authority (Art. 5 of ILC Draft Articles – the functional test)
  - (iii) As acting on the instructions of, or under the direction or control of the State (Art. 8 of ILC Draft Articles – the control test)
  
- **A separate analysis – if the act is inconsistent with any relevant obligation of the State**, such as those in the BITs.

## (2) Contracts concluded with State Subdivisions / Agencies and State-owned Companies

### Art. 4 of ILC Draft Articles – the structural test

#### “Conduct of organs of a State

1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever character as an organ of the central government or of a territorial unit of the State.
2. An organ includes any person or entity which has that status in accordance with the internal law of the state.”

## (2) Contracts concluded with State Subdivisions / Agencies and State-owned Companies

### Art. 5 of ILC Draft Articles – the functional test

**“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.”

### Art. 8 of ILC Draft Articles – the control test

**“Conduct directed or controlled by a State**

The conduct of a person or group of persons shall be considered an act of a State under international law if the person or the group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct”



*Noble Ventures Inc. v. Romania*, ICSID Case No. ARB/01/11, Final Award, October 12, 2005

**Umbrella clause: “Each Party shall observe *any obligation it may have entered with regard to investments*” [US-Romania BIT, Art. II (2) (c)]**

- Are the acts of State agencies (privatization authorities in *Noble Ventures* case) which are alleged to constitute violations of the BIT attributable to the Respondent State?
- Can the Respondent State be regarded as having entered into the respective contract (SPA)? Is the contract attributable to the Respondent State?
- If the answer is yes, then “*a breach of contract that is attributable to the Respondent State is capable of constituting a breach of international law by virtue of the breach of the umbrella clause of the BIT.*” (Award, para.85)

And.....

*EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13,  
Final Award, October 8, 2009

**Umbrella clause: “Each contracting party shall observe any obligation it may have entered into with regards to investments of nationals or companies of the other contracting party” [UK-Romania BIT Art. 2(2)]**

*“It is unclear whether Claimant relies on the attribution to the State of certain acts and conducts of AIBO and Tarom on the assumption of their being in breach of the contracts in order to impute to the State the responsibility for such breach. If so, this construction of the umbrella clause would be incorrect since the attribution to Respondent of AIBO’s and Tarom’s acts and conduct does not render the State directly bound by the contracts for the purpose of the umbrella clause.” [Award, para.318]*

### (3) Forum Selection and the Jurisdiction of an International Tribunal under International Investment Treaties

➤ Contract in dispute contains its own dispute resolution clause – e.g. domestic courts, domestic arbitration, .

• *LANCO v. Argentine, Vivendi 1, Salini v. Morocco, SGS v. Pakistan*: Does not affect the competence of an international tribunal based on an international investment treaty.

• A different approach: *SGS v. Philippines* – a contract claim cannot be pursued under an “umbrella clause” unless the investor, for good reasons, was prevented to avail itself of the exclusive domestic remedies provided for in the contract.

## (4) *Litis Pendens* and “Fork-in-the-Road” Clauses

- Example of “Fork-in-the-road” clause:  
*“Once the investor has submitted the dispute to the competent tribunal of the Contracting Party in whose territory the investment was made or to international arbitration, that election shall be final”*
- Relevant jurisprudence:  
*Vivendi 1, CMS v. Argentina, Alex Genin v. Estonia*
- Same dispute? Same cause of action?