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Construction Contracts in International Investment Arbitration

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1 CHAPTER I - INTRODUCTION

1.1 Background

Construction is one of the main business sectors worldwide. Cross-border construction activities are rapidly increasing, in particular in developing countries, since growing amount of construction projects are being awarded to multinational companies. Though as per the United Nations World Investment Report 2018 greenfield project values decreased in 2017 in parallel with the decline of the value of announced Foreign Direct Investment(FDI) greenfield projects and the value of net cross-border M&As, the recent years' reports, including the United Nations World Investment Report 2017, reflect that FDI in construction sector is in increase.[1]

States are, through their entities, entering into construction contracts with companies engaging cross-border activities for construction projects such as highway, sewer system or other types of infrastructure systems etc. In overwhelming majority of these contracts, if not all, states are party to the contracts with the capacity of "employer" or "owner".[2] The financial enormity and the nature of the construction projects make them prone to political interference and affected by economic instability and government policies. Furthermore, with the ascending use of public-private partnership (PPP), states are committing to long-term project structures only to encounter financial insecurity years down the line, resulting in the state's suspension or cancellation of the project.[3] This leads investors to seek for a remedy provided by international investment agreements against the measures taken by states.

In parallel with the abovementioned increase in FDI and increasingly growing number of international investment agreements worldwide, a large number of international investment disputes are arising from construction sector. In 2017, 9 new construction cases were filed whereas 6 cases were filed in 2016 to international arbitral tribunals.[4] In detail, it can be es-

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[1] The concept of greenfield investment means the creation of a firm from scratch, or the extension of existing investment by non-resident investors.

European Commission, "Greenfield Investment Monitor.". UNCTAD, "World Investment Report 2018." and UNCTAD, "World Investment Report 2017."

[2] For convenience where 'employer' or 'owner' is mentioned the reference is made to the host State, *i.e.* the state where a particular investment was made, whereas 'contractor' makes a reference to the investor which is a private person or entity from another state, *i.e.* the home State.

[3] Global Arbitration Review, "Construction Disputes in Investment Treaty Arbitration."

[4] UNCTAD, "World Investment Report 2018.". UNCTAD, "World Investment Report 2017."

tablished that an approximate 145 cases arising out of construction investment disputes have been filed as of this writing. Out of this, 117 cases have been registered to the International Centre for Settlement of Investment Dispute (ICSID/the Centre), which administers more than 70% of all known international investment proceedings, whereas 8 of them are registered to the United Nations Commission on International Trade Law(UNCITRAL). The rest 20 were brought before the other institutions such as Stockholm Chamber of Commerce(SCC), Permanent Court of Arbitration(PCA) or International Chamber of Commerce(ICC). While 85 of the cases that have been registered to the Centre have been concluded, the remaining 32 is still pending.[5] Among the cases brought before the Centre, only 1 case was filed by a State, i.e. Gabon against Societe Serete S.A. for construction of a hospital maternity ward, whereas the rest has been filed by contractors.

This ascending trend is similarly reflected in ICSID's caseload statistics. Construction disputes represents 7, and recently 8, percent of the ICSID caseload since 2010.[6] Moreover while 17% of the cases that are registered in Financial Year(FY) 2017 to ICSID is construction disputes as per the 2017 annual report, the caseload statistics published in 2018 illustrates that 11% of the new cases registered in FY2018 is related to construction disputes. [7]

One of the paramount aims of investment law is to protect foreign investment. To achieve this host states are accepting legal obligations towards investors. However, considering the economic and political importance of investment, they may take measures that are incompliant with these obligations. Given that states are party to the contract in construction sector and their governing laws vary, treatments towards investors may be in contradiction with protection mechanisms that states are obliged to provide under respective International Investment Agreements(IIAs), either Bilateral Investment Treaties(BITs) or Multilateral Investment Treaties(MITs).

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[5] These numbers are as of 1 August 2018. Number of the cases regarding construction sector differs from source to source. The main reason is the lack of a consensus for what qualifies a construction dispute. For an accurate reflection of the case law all the cases registered in arbitral tribunals were went through and every case that can be qualified as construction dispute is included in the number given.

[6] ICSID Caseload Statistics between (Issue 2017-1) and (Issue 2010-1).

[7] ICSID, "The ICSID Caseload Statistics (Issue 2017-2)." & ICSID, "The ICSID Caseload Statistics (Issue 2018-2)."

1.2 Research Question

The objective of this study is first to identify the main practical problems in international construction investments and then to examine and reveal the specificities of construction contracts within the context of international investment arbitration which distinguish it from other contractual arrangements and FDI investments, thereby provides, or deprives them of, international investment protection within the meaning of both jurisdictional and merit aspects. In fact, construction contracts are distinguished from other contractual arrangements in many senses. To illustrate, in construction contracts the payment is generally fixed, *i.e.* agreed to be paid as per an agreed schedule with installments. This often arises question of whether contractor bears a certain risk which is necessary to identify the activities as investment.[8] As doing so, the study will only focus on construction contracts entered into between a private company and a state, state entity or state company. The study aims to offer a general overview of the main issues and how arbitral tribunals have approached them.

Apart from the above, in international construction sector generally standard types of contracts are being used. FIDIC and NEC standard contract templates, issued by International Federation of Consulting Engineers and Institution of Civil Engineers respectively, are, for example, very commonly favored by investors and states. In addition to the fact that numerous projects where one or other of the FIDIC contracts is selected for use, there are indirect influences for use as standard forms.[9] There has been extensive usage of FIDIC Contracts as a model for public works contracts, in particular in Middle East. They are also widely used in Africa, especially in countries with a common law tradition. [10] Since standard types of contracts are used in practice and these contracts are aimed to be self-sufficient, naturally similar kind of problems arise. This brings about the question of whether standard contract clauses may be the very reason for the disputes. However, this study does not attempt to provide a comprehensive answer to this question since such disputes are contractual in their nature and outside the scope of international investment arbitration. It may touch upon these however where state's sovereign act is the very root of the breach of an obligation or where a characteristic of construction contracts is explained.

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[8] Manciaux, "The Notion of Investment: New Controversies," 463.

[9] Ellis et. al., *FIDIC Contracts, Law and Practice,* vii.

[10] *Ibid.* 14-15.

1.3 Justification

One of the reasons of this study is to identify the causes of the increasing number of disputes. On one hand, construction is a globally growing sector. A report – Global Construction 2030 – forecasts the volume of construction output will grow by 85% to $15.5 trillion worldwide by 2030.[11] Likewise, it is one of the leading investment sector and hot investment vehicle. This trend shows itself in United Nations World Investment Reports. In 2016, the value of the total FDI greenfield projects in construction sector was $126 billion with a total of 322 projects which made the sector as the second most invested FDI sector globally after 'Electricity, gas and water'. The same figure is $62 billion with 276 new FDI projects which made the sector fourth most invested one in 2017.[12] States, the developing ones in particular, are utilizing foreign investment to render themselves prosperous. To illustrate, the construction sector of the State of Qatar, listed as developing economy by United Nations, set to award $85 billion worth of construction projects in addition to the ongoing construction projects.[13]

On the other hand, considering that the number of construction disputes is increasing, investors might take cautious steps. Whilst previous construction disputes were forming around 7-8% of ICSID caseload this has arisen to 17% last year though the total number of cases registered has not changed drastically.[14] A review of ICSID and UNCTAD websites reveal that disputes are not limited to a type of construction but involving various projects including hotel, airport terminal, dam, fertilizer factory, residential and commercial complex, office building, highway, university facilities, road, tunnel, waterway etc. This might affect investors to reconsider investing in construction sector. The increasing role of PPP and economical enormity of projects and its burden of public expenditure indicate that they may be more prone to political interference than other investment sectors. One of the main risks of a contractual arrangement between an investor and a state-entity in construction sector is thus that the decisions may be taken often with political concerns rather than contractual obligations. As a demonstration, in amid the financial meltdown one of the first things Turkey has done is that it has lately halted all the public construction projects.[15] Similarly, Mexico recently halted $13

[11] Institution of Civil Engineers, "Global Construction 2030."

[12] UNCTAD, "World Investment Report 2018."

[13] UN, "Country Classification." and Trade Arabia, "Qatar set to award $85 billion construction projects."

[14] 49 cases registered in 2017, 45 in 2016. 50, 40, 38, 52 cases registered between 2012-2015 respectively.

[15] Independent, "Erdogan's legacy construction projects stall amid Turkish financial crisis."

billion airport construction project.[16] It is observed in the case law that the disputes in construction contracts arose, as alleged by investors, mostly out of change in political or economic environment. Some of general roots of disputes are; early termination of the contract to grant it to another company or make economic savings as a new government policy, expropriation of the construction project due to change in politics etc. Hence, it seems like in addition to normal contractual risks that every contract carries, there is also an inherent risk, which occurs with considerably high ratio, in entering into contractual relationship with a state-entity in construction sector due to the openness of these contracts to political interference.

In brief, much as construction investments are vehicles to build up a state they are also sensitive. Now with the increasing number of investment disputes there may be a hesitation by investors for new projects. Uncertainties may jeopardize the sector as investors may decide not to invest in risky business. It is thus helpful to identify the main problems and to elucidate the arbitral tribunals' approach to parties' claims, both for jurisdictional and merit-related, to help reducing the number of construction disputes and create a friendlier environment.

Furthermore, there has not been a detailed, comprehensive research on construction contracts and associated disputes brought before international arbitral tribunals. In this study, by going through the case law, it has been tried to bring the disputes arising from construction contracts to get a better grasp of the problems that arise between investors and states which would in turn provide a better insight for possible solutions for such disputes.

It is also important to carry out a comprehensive jurisprudence of the case law. Though tribunals, ICSID in particular, are not bound by previous decisions, it is important to follow established solutions to provide a predictable legal framework and thereby to help reducing the backlog. The same was stated in *Bayindir v Pakistan* as: "*The Tribunal…is of the opinion that it should pay due regard to earlier decisions of such tribunals. The Tribunal is further of the view that, unless there are compelling reasons to the contrary, it ought to follow solutions established in a series of consistent cases, comparable to the case at hand… to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law."*[17]

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[16] Economist, "Mexico's incoming president halts an airport project, and pays a price."

[17] ICSID, "Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan(ICSID Case No. ARB/03/29)." Award of 27 August, 2009, para. 145. (hereafter, *Bayindir v. Pakistan*)

1.4 Methodology and Sources

The study will use legal desk research method and analyze construction-related cases in investment arbitration. Though 145 cases have been found to this extent not all of them are analyzed herein. The reasons for that are: a-only those cases that contain contract between a contractor and a state entity are taken into account; b-not all of the cases are published due to confidentiality; c-huge amount of cases are still pending. The same method is used to collect normative legal texts, jurisprudence of courts, if any, scholarly writings, reports, texts, documents and statistics of institutions, historical documents, and news reports.

Comparative analysis method is used to compare different positions and arguments of courts, judges, and legal scholars. Linguistic analysis method is used to interpret various legal terms and principles. Logic analysis method is used to infer conclusions whereas theoretical analysis method is used to interpret legal sources based on general theory of law.

1.5 Structure

The study consists of four chapters. After this paragraph, jurisdictional issues are to be dealt with. The chapter will partly set out an overview of the factual background of some construction cases where the case law is examined. The third chapter will examine the question of whether an act of a state organ who is in contractual relationship with a construction corporation can be attributed to a state. In the fourth chapter, the claims that correspond to the merit of the case are to be examined. It aims to investigate the problems that are or may be possible barriers to attracting foreign investment to construction sector and draws a picture of the current situation and possible risks that would prevent new construction investments from inflowing. The fifth and last chapter contains a conclusion of the general view of the current situation as a means of helping to fostering the cross-border construction investments.

2 CHAPTER II - JURISDICTIONAL MATTERS

2.1 Introduction

International investment treaties give investors the chance to bring claims before international arbitral tribunals. For doing so, however, investor's activities have to be qualified as investment. As mentioned above, contractors enter into construction contracts with state-entities. Whether these construction contracts qualify as investment, thus entitling contractor to bring claim, is essential to proceed with the claim.

In retrospect the biggest contribution to protect investors' rights is the ICSID Convention(the Convention) and foundation of the Centre since it had become the main forum for dispute resolution by 1990s.[18] Therefore, the qualification, criteria and approach that the Centre conducts when identifying whether an investor made an investment is important within international investment law context.

This chapter will first set forth the general criteria for the notion of 'investment' within the meaning of investment treaties and the Convention and then analyze the threshold for construction contracts for being qualified as 'investment'. By doing so, the characteristics of construction contracts that play a role when qualifying them as investment will be emphasized.

Investment as subject-matter is essential to establish jurisdiction *ratione-materiae*. Of course there are other jurisdictional challenges a party has to overcome to argue the Centre's jurisdiction. For investments in the form of a contractual arrangement, these jurisdictional challenges can be as: whether the Claimant qualifies as investor, whether the case has *prima facie* standing that the claims are capable of bringing about a breach of treaty, whether the contractual jurisdiction clauses prevent investors from bringing the case before the Centre etc.[19] However, nothing is specific to construction contracts in regards to these matters and, therefore, this part will only deal with the notion of 'investment' for the purpose of jurisdiction *ratione-materiae.*

2.2 The notion of 'Investment'

From the outset, the Convention does not attempt to provide for substantive standards but lays out procedures for settlement of disputes. The Centre's jurisdiction is articulated in Article 25 of the Convention. Accordingly, the host state first has to give a consent to an investor to

[18] Dolzer, Schreuer, *Principles of international investment law*, 9.

[19] Alvik, *Contracting with Sovereignty: State Contracts and International Arbitration,* 145.

submit its claims to the Centre. This consent is generally given through BITs or MITs signed with the home states of the investor. In the same treaties the states also define what an investment is for the purpose of the protection. Hence the activity that the investor carries out has to be qualified as investment in relevant treaty.

Secondly, Article 25 of the Convention also mentions that a dispute has to arise out of an 'investment'. The Convention does not contain a definition of this term, and, moreover, the *travaux préparatoires* shows that the task of defining the term was implicitly left to the arbitrators in charge of ruling.[20] This can create an inchoateness in jurisprudence but one thing is clear that the activity needs to be qualified as investment.

Thus for a Tribunal to decide that it has jurisdiction over a claim it conducts double test, namely; a-whether the activity constitutes an investment as per the relevant treaty, b-whether the activity constitute an investment within the meaning of Article 25 the Convention.

2.2.1 Definition of 'Investment' in IIAs

An international treaty, bilateral or multilateral, is a treaty entered into between two, in case of bilateral, or more states, in case of multilateral, that constitutes a legal framework for the treatment of investment flows between the contracting parties.[21] They generally define the term 'investment' to embody the scope of protection. Examples are the Energy Charter Treaty(ECT), which defines the term in Article 1/6,[22] NAFTA, which defines it in Article 1139 [23] and The Association of Southeast Asian Nations(ASEAN) Comprehensive Investment Agreement with its definition in Article 4/c. Pertinent to mention, however, is that there is not many multilateral treaties signed by many states and covers substantive protection standards. They are still mostly laid out through Bilateral International Treaties. This naturally causes difference in the definitions of investment since there are currently 2958 different BITs, out of which 2361 is in force.[24] Most bilateral investment treaties contain clauses where investment

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[20] Manciaux, "The notion of investment, new controversies," 446.

[21] Cremades, Cairns, "Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes," 326.

[22] In Article 1/6 of the Energy Charter Treaty investment is defined as:-

"A)every kind of asset, owned or controlled directly or indirectly by an Investor and includes: (a)(b)(c)(d)(e)(f)"

[23] NAFTA, as per Article 1139 investment means:

"(a) an enterprise;(b),(c),(d),(e),(f),(g),(h),(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts,(j)…"

[24] UNCTAD, "Investment Policy."

is defined with several illustrative investment categories. Thus, there generally does not arise questions when an activity is covered by one of these illustrative categories.[25]

The term has been defined various ways in different international treaties. Some Treaties provided for very broad definitions. BIT between Germany and Sri Lanka, dated 1963, for example, defines that the term shall compromise all categories of assets including rights and interests. [26] Others are constructed to be suitable for economic usage. The BIT between Ukraine and Denmark, dated 1992, puts a special focus on lasting economic relations and defines 'investment' as *'every kind of asset connected with economic activities acquired for the purpose of establishing lasting economic relations'*.[27] Some other treaties focuses on providing for characteristics of an investment rather than setting forth a demarcation with an illustrative or exclusionary list of activities whereas some others, as in the case of US Model BIT 2004, provide for both the characteristics of an investment and non-exclusive list of forms that an investment may take.[28]

Special issues arise where the definition itself contains a reference to the term 'investment', as in the case of Article 1/6-c of ECT. Sometimes definition refers to rights granted by domestic laws of host state, which is important in particular where contractual rights are defined as investment. In such cases, recourse to the host state's national law will be required. [29]

2.2.2 Definition of 'Investment' within the meaning of Article 25 of the Convention

Although it appears in the center of the Convention, investment does not have a definition in the text of the treaty. While it has been argued by some that the term has subjective meaning, that is the will of the parties, others have argued that it has objective meaning, which is the notion entails elements that include contribution, duration and risk. The Tribunals have also been arguing whether the term has an inherent meaning. The Tribunal in *Fedax v Venezuela* made an initiative and ruled that Article 25 provided a broad meaning to the term. The tribu-

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[25] Dolzer, Schreuer, *Principles of international investment law*, 63.

As a demonstration, 2012 U.S. Model BIT the term is defined in Article 1 as; *"... Forms that an investment may take include: (a) an enterprise;(b)... (c)... (d)...(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f)...(g) ...(h)"*

[26] See Germany-Sri Lanka BIT dated 1963.

[27] See Ukraine-Denmark BIT dated 1992, Article 1(1).

[28] See the US Model BIT-2004 Article 1.

[29] Dolzer, Schreuer, *Principles of international investment law*, 64.

nal listed 5 criteria; a certain duration, a certain regularity of profit and return, assumption of risk, a substantial commitment and a significance for the host state's development.[30]

Out of Fedax's legacy the approach arose that would become known as 'Salini' criteria in *Salini v Morocco* case. The Tribunal set forth therein the four well-known criteria for the term, *i.e.* contribution, a certain duration, assumption of risk and contribution to the host state's development, and in subsequent rulings arbitral tribunals opted to follow this approach.[31] Much as tribunals are not bound by previous decisions and some Tribunals made digressions from Salini criteria, such as the tribunal in *Biwater Gauff v Tanzania* wherein the Tribunal said that the Salini criteria might exclude certain types of project from protection of ICSID, the criteria are still highly used by tribunals.

The meaning of the term has also been discussed among the scholars. After stating the possibility of identifying certain features of investment, Schreuer mentioned 5 criteria, i.e. duration, regularity of profit and return, risk, substantial commitment and operation's significance for the host state's development. He further added that these should be understood as characteristics of investments rather than as jurisdictional requirements.[32]

The main question when defining the notion is whether it should be understood with an objective or self-contained approach, or it should be understood on subjective or party-defined approach. Whilst the negotiating history of the Convention demonstrates that a subjective or party-defined approach, in practice the Tribunals have also tried to create an objective meaning. ICSID tribunals have taken an approach that combines the two since the combination serves as proper approach.[33]

2.3 Fundamental concerns

The nature of construction contracts and projects distinguishes it from other types of contractual arrangements in a way that causes concerns as to whether they are investments for jurisdiction purpose. This is especially the case a-if the contractor's remuneration is certain, b-if the contract is free-standing construction contract rather than a package of activities for estab-

[30] ICSID, "FEDAX N.V. v. The Republic of Venezuela(ICSID Case No. ARB/96/3)." Decision on Jurisdiction, para. 43. (hereafter, *Fedax v Venezuela*)

[31] Dolzer, Schreuer, *Principles of international investment law*, 66.

[32] Schreuer, *The ICSID Convention: A commentary*, 140.

[33] Yala, "The Notion of "Investment" in ICSID Case Law: A Drifting Jurisdictional Requirement?," 106.

lishment of a business, i.e. multiple contractual arrangements. There seems to be an approach in some scholarly writing that these should not be considered as investment. Thus, I will discuss with pros and cons the principal issues arose from nature of construction contracts for the jurisdiction purpose.

One difficulty stems from contribution criterion. From the beginning of the discussions on the definition of 'investment', the contribution criterion seems to be consensual. It has been consistently put forth by ICSID Tribunals.[34] Contribution is made by an investor with the hope of obtaining a remuneration, which is sometimes presented as a different criterion.[35] What distinguishes an investment from other transactions is the uncertainty of such return.[36] In construction contracts, however, the payment is generally fixed with the signing of the contract and made by installments following the progress of works. Therefore, it has been argued that these type of contracts should not be qualified as investment contracts.[37] Manciaux says that it is possible to qualify construction contracts as investment *'…only if the entrepreneur's remuneration depends at least in part on the operating of the constructed ensemble before it is ceded back to the developer : such as in BOT or concession contracts.'*[38] Thus some transactions that the Tribunals found to have constituted investment, as per Manciaux, does not constitute investment.[39] Yala parallelly says that the criterion distinguishes an investment in construction from a mere sale contract is that a seller would get remuneration upon delivery of a project whereas an investor is paid from the profits of the exploitation of the project delivered.[40] This feature of construction contracts is also related to risk element of investment as the contractually agreed amount is to be paid by installments, thereby the activities are lack of economic risk.

Though it is true that fixed payment provides for some certainty, the uncertainty can arise due to changes of specifications of project, i.e. variations. As it is explained below, contractor is

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[34] See ICSID, "Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco(ICSID Case No. ARB/00/4)." Decision on Jurisdiction. (hereafter, *Salini v Morocco*)

[35] Schreuer, *The ICSID Convention: A commentary*, 140.

[36] *Ibid.*

[37] Manciaux, "The notion of investment, new controversies," 460-463.

[38] *Ibid.*

[39] *Salini v Morocco, Bayindir v Pakistan.* Also see Italaw, "Saipem S.p.A. v. People's Republic of Bangladesh(ICSID Case No. ARB/05/7)." (hereafter, *Saipem v Bangladesh*)

[40] Yala, "The Notion of "Investment" in ICSID Case Law: A Drifting Jurisdictional Requirement?," 113.

bound with employer's variation instructions. However, cost and time effect submitted in against are evaluated and approved by employer. Moreover, employer instructs contractor to continue with variated works before they approve the cost and time impact of the variation. If contractor does not comply with such instruction until its claims are approved, then it may face with punitive measures such as delay penalty. One wonders then whether remuneration is still certain in variation or any other additional claim situations, since contractor has no option but to comply with instructions and it is at employer's discretion to decide the size of the impact. Where the approved impact is less than anticipated and thereby contractor incurs losses, can one really argue that remuneration was certain? It is true that the presence or absence and content of such clauses are up to bargaining power of the parties and uncertainty stems from their will.[41] But if the criterion is formed, does it really matter if it is taken freely? Salini Tribunal answered negatively.[42]

Similarly, agreed contractual amount changes with geological and meteorological difficulties, increased cost of labor, increased cost of material, force majeure etc. Considering that the duration of the project will be at least 2 years, it is normal to assume that such difficulties endured long time may significantly impact the return expectations of contractor. [43] Though there is a margin put in bid in tender stage for such conditions, or claim clauses are incorporated in contract, one cannot forecast entirely the impact of such difficulties. Moreover, the impact is assessed by employer and thus the contractual clauses may not be enough to cover the risk. In the presence of such conditions, thus, it may be hard to say that the remuneration is certain. The same is accepted by the Tribunals.[44]

The risk taken is mainly economic. However, this economic risk is supported by political risk. Investor's contribution is open to intervention by the host State due to any political turns of events which would reduce or diminish the economic expectations. This is especially the case with construction contracts since contractor attaches its investment to the host state's territory and thus losses the possession of it. In a conflict with sellers or service providers in other sectors, investors may hold the possession of their product and free themselves from political risk to some extent. This is not the case for construction investments due to its nature. Hence, con-

[41] Manciaux, "The notion of investment, new controversies," 461-462.

[42] See para. 56 of *Salini v Morocco,* Decision on Jurisdiction.

[43] As per Salini the duration is at least 2 years. See *Salini v Morocco,* para. 54.

[44] See *Bayindir v Pakistan,* Decision on Jurisdiction, paras. 135-136.

struction contracts have an inherent risk additional to economic risk. So it can be argued that no payment schedule provides for certainty since the activities are open to political interference and last over years and thereby carries political risk.

Another difficulty derives from the 'contribution to host state's economic development' criterion especially when stand-alone construction contract is at the issue. It is argued that in these cases the contractor only provides materials and services for a sum that covers the costs and a profit and when the works are complete it returns home with equipment, plant, personnel and profit.[45] Thus, it is questionable whether contractors actually transferred any know-how or technology to the host state. Yala seems to reject it with the following words: *'When a bricklayer comes to your home, builds a wall, and you pay him for his work, do you consider that he has made a 'contribution' to your benefit- that he has 'invested' in your garden, your kitchen or your living room?'*[46]

Although level of benefit is minimal, it still exists. It is uncertain that what level of benefit constitutes the threshold for investment protection. Investments are made by small, middle or large companies and it is not clear whose investment brings benefit. There is also no indication in IIAs or in the case law imposing a proportion between the size of investor and the level of benefit it has to bring.[47] If the approach in the previous paragraph is accepted, the result may be discriminative application of protection, to advantage of large multinational companies and detriment of small companies, which is not really the objection of the Convention.[48]

Stand-alone construction contracts also create some concerns regarding duration where project duration is insufficient. Contractors come to the host State to construct a project, executes the activities and leaves in less than a certain time. This is argued by states in arbitral tribunals.[49] Although there is the criterion accepted by Tribunals for 'investment' purpose, there is no consensus as to how long it must be. Additionally, contractors execute its activities in host State in pre-contractual stage as well as after taking-over stage in the form of warranty and

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[45] Colaiuta, Craig, "Construction contracts as 'investment' for the purposes of investment treaty arbitration," 108.

[46] Yala, "The Notion of "Investment" in ICSID Case Law: A Drifting Jurisdictional Requirement?," 111.

[47] Colaiuta, Craig, "Construction contracts as 'investment' for the purposes of investment treaty arbitration," 108-110.

[48] *Ibid.*

[49] See *Saipem v Bangladesh*, Decision on Jurisdiction. para. 101.

maintenance period. Thus, a contractor's obligation and expenses in practice are not limited to project duration.

2.4 Case law

The study now turns to the case law to see tribunals' approach. Since the tribunals made references to previous judgements, to understand how jurisprudence is evolved and developed, the cases will be mentioned in chronological order. The Centre dealt with disputes involving construction contracts prior to the cases mentioned herein.[50] In fact, the first case submitted to ICSID Arbitration, *i.e. Holiday Inn v Morocco*, arose out of a construction project and involves a construction contract. However, in these cases the contracts were part of overall projects of investors that included other contractual arrangements between the parties.[51] The Tribunals therein did not examine whether construction contracts separately constitute investment but considered that they qualify as investment due to cumulativity of the project.[52]

In *Lanco v Argentina,* the dispute arose out of agreement between for developing and operating terminals at Puerto Nuevo. The Tribunal stated that 'investment' is very broadly defined in BIT. It examined the participation in the Agreement to qualify activities investment. It analyzed the Claimant's liability for the performance of the Agreement and once it found that the Claimant is liable for the contractual obligations against the State, it said that the Agreement is an investment agreement.[53]

In *Salini v Morocco,* the dispute arose out of the contract, for the construction of a highway joining Rabat to Fes, related to the final account and the payment of certain invoices. The Tribunal, after setting out the four well-known criteria, said for contribution criterion that the Claimant used their know-how, provided the equipment and qualified personnel, set up the production tool on the building site, obtained loans and agreed to issuing of bank guarantees

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[50] See cases Holiday Inns S.A. and others v. *Morocco*(ICSID Case No. ARB/72/1), Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais(*ICSID* Case No. ARB/81/2), Société Ouest Africaine des Bétons Industriels v. *Senegal*(ICSID Case No. ARB/82/1).

[51] Yala, "The Notion of "Investment" in ICSID Case Law: A Drifting Jurisdictional Requirement?," 107.

[52] Carreau, Flory, Julliard, "Chronique de droit international economique," 773-781.

[53] ICSID, "Lanco International Inc. v. Argentine Republic(ICSID Case No. ARB/97/6)." Decision on Jurisdiction, 1998. paras. 15&16. (hereafter, *Lanco v Argentine*)

in the form of both provisional and definite and the Claimant *"…therefore, made contributions in money, in kind, and in industry."*[54]

For risk the Tribunal said, as later repetitively quoted by other tribunals that *'…these flow from the nature of the contract at issue. The Claimants…gave an exhaustive list of the risks taken in the performance of the said contract. Notably, among others, the risk associated with the prerogatives of the Owner permitting him to prematurely put an end to the contract, to impose variations within certain limits without changing the manner of fixing prices;…;…; …; …;…. It does not matter in this respect that these risks were freely taken. It also does not matter that the remuneration of the Contractor was not linked to the exploitation of the completed work. A construction that stretches out over many years, for which the total cost cannot be established with certainty in advance, creates an obvious risk for the Contractor.'*[55]

Regarding the contribution to the host state's development the Tribunal stated that this cannot be questioned since infrastructure works are state's obligation and the project shall serve public interest. The Claimant also provided know-how to the host state. [56]

In *Consortium RFCC v Morocco*; the dispute arose out of a construction contract for the construction of motorway linking Rabat to Fes. The Tribunal said that the Consortium made transfers of funds, equipment, personnel and know-how, created an establishment for importing commercial construction, imported equipment, thus made contributions in cash, in kind and in industry. The Tribunal said that the contract meets the minimum duration with the postponed hand-over date. The Tribunal accepted the presence of risk and contribution to the host state's development criteria with the similar reasoning in Salini v Morocco.[57]

In *Autopista v Venezuela*, the Claimant entered into highway construction contract with the Respondent to design, construct, operate, exploit, conserve, and maintain the Caracas–La Guaira Highway and the Caracas–La Guaira old road. The Tribunal found that *"…the perfor-*

[54] *Salini v Morocco*, Decision on Jurisdiction. para. 53.

[55] *Ibid.* para. 55.

[56] *Ibid.* para. 57.

[57] ICSID, "Consortium R.F.C.C. v. Kingdom of Morocco(ICSID Case No. ARB/00/6)." Decision on Jurisdiction. paras. 61-66. (hereafter, *Consortium RFCC v Morocco*)

mance of the Agreement, which implies substantial resources during significant periods of time, clearly qualifies as an investment in the sense of Article 25 of the ICSID Convention."[58]

In *Consortium LESI v Algeria*, the dispute arose out of a contract for the construction of the Koudiat-Acerdoune dam. The Tribunal said that a contract to be considered an investment should fulfill three conditions, *i.e.* contributions, certain duration, and risk. For the host country's economic development criterion, it said that *"something that is difficult to ascertain and that is implicitly covered by the other three criteria"*. For the three criteria, it found that:

"…With respect to contribution the Claimant insists that it committed significant resources to the construction and the Tribunal it must accept that reality… With respect to duration, … The Contract involved construction of the Koudiat Acerdoune Dam in the District of Bouira; its minimum duration was exactly 50 months. One must not interpret the matter too rigorously, for experience shows that projects of this kind often justify extensions, without mentioning the duration of the warranty. With respect to risk …the risk in question can in fact apply to any contract that implies increased risk for the contracting party. It is not sufficient for the State to show that the contract offers control mechanisms..."[59]

In *Bayindir v Pakistan*, the dispute arose from contract for the construction of "Pakistan Islamabad-Peshawar Motorway". [60] The Tribunal said that a construction contract of a highway is more than a construction in traditional sense and referred to Aucoven case wherein the Tribunal noted that, the construction of a highway *"...which implies substantial resources during significant periods of time, clearly qualifies as an investment."* [61]

The Tribunal applied the Salini criteria and found that: - *"…it cannot be seriously contested that Bayindir made a significant contribution, both in terms of know how, equipment and personnel and in financial terms.*[62] For duration "*…Contracts over similar periods of time have been considered to satisfy the duration test for an investment… as mentioned…in L.E.S.I. v. Algeria, one cannot place the bar very high, as (a) experience shows – and a preliminary as-*

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[58] ICSID, "Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela,(ICSID Case No. ARB/00/5.)." Decision on Jurisdiction. paras. 100&101. (hereafter, *Autopista v Venezuela*)

[59] ICSID, "Consortium Groupement L.E.S.I. - DIPENTA v. People's Democratic Republic of Algeria(ICSID Case No. ARB/03/8)." Award of 10 January, 2005. para. 14. (hereafter, *Consortium LESI v Algeria*)

[60] *Bayindir v Pakistan*, Decision on Jurisdiction, paras. 10&11.

[61] *Ibid.* para. 128.

[62] *Ibid.* para. 131.

sessment of the facts of the case seem to confirm – that this kind of project more often than not requires time extensions, and (b) the duration of the contractor's guarantee should also be taken into account. [63] For the risk, though Pakistan argued that Bayindir received a mobilization payment which minimalized the risk engaged, the Tribunal rejected this by stating that *'…Besides the inherent risk in long-term contracts, the Tribunal considers that the very existence of a defect liability period of one year and of a maintenance period of four years against payment, creates an obvious risk for Bayindir.* [64] For contribution, the Tribunal said that this criterion is included in other three criteria.[65]

In *Jan de Nul v Egypt,* the dispute arose out of a contract for the widening and deepening of the Suez Canal. Where the Tribunal discussed the contract as subject-matter of the dispute it said that "*…the amount of work involved (including the mobilization of two heavy ships for a period of approximately 19 months) and the related compensation show that the Claimants' contribution was substantial. Moreover, there can be no question that an operation of such magnitude and complexity involves a risk and one cannot seriously deny that the operation of the Suez Canal is of paramount significance for Egypt's economy and development."*[66] Regarding duration, Claimant argued that in the construction industry an investment starts from pre-qualification, *i.e.* pre-tender or tender stage, as investor starts spending money and making expenditures when preparing the offer. Tribunal found that the criterion is met, as the duration of the operation was sufficient.[67]

In *ADC v Hungary,* the dispute arose out of a construction contract, for the construction, renovation and operation of airport terminals. The Tribunal rejected jurisdiction *ratione-materiae* objections by stating that *"…it is the substance of the transaction that reveals the answer as to whether any investment was made."* There is an investment made on the part of the Claimant and this was on the basis of the effect of all of the project agreements taken together, which showed that an investment of approximately $16.765 million had been made.[68]

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[63] *Ibid.* para. 133.

[64] *Ibid.* para. 134-136.

[65] *Ibid.* para. 137.

[66] ICSID, "Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt(ICSID Case No. ARB/04/13)." Decision on Jurisdiction. para. 92. (hereafter, *Jan de Nul v Egypt*)

[67] *Ibid.* paras. 94-95.

[68] ICSID, "ADC Affiliate Limited and *ADC* & ADMC Management Limited v. The Republic of *Hungary*(ICSID Case No. ARB/03/16)." Award of 2 October, 2006. para. 325. (hereafter, *ADC v Hungary*)

In *Saipem v Bangladesh*, the dispute arose out of a contract, to build a pipeline of 409 km. Bangladesh argued that the works under the Contract were performed for less than a year.[69] The Tribunal rejected this by stating that Bangladesh did not put forth any reason why only effective work should be taken into account as the applicable criterion. It said that *"…the time of the project during which the works are interrupted or suspended entails risks that may even be higher than those incurred while the works are being performed."* [70]

Bangladesh argued that the Claimant is not a creditor having actually put its own money. The Tribunal distinguished this into two, *i.e.* the origin of the funds and the commercial risk incurred by the investor. Regarding the former, it said that in the absence of a requirement that fund is to be imported, the origin of the fund is irrelevant and investments can be made by from local funds or from loans raised in the host State. The latter is argued because the Claimant received advance payment. The Tribunal rejected this stating that the undisputed stopping of works and necessity to renegotiate completion date, Retention Money are examples of risks in long-term contracts. It considered the entire operation and found that it includes the Contract, the construction, the Retention Money, the Warranty and ICC Arbitration and concluded that there is an investment. [71]

In *Pantechniki v Albania*, the dispute arose from two construction contracts for bridges and roads. The Claimant's road work site was overrun and ransacked by looters during severe civil disturbances. The Tribunal stated that a common meaning of investment would prevent conflict but it is not its role to set forth a line for the notion and then rejected the Respondent's objection by the following words: *'…Albania cannot and does not dispute that the Claimant committed resources and equipment to carry out the works under the Contracts. Its own officials have accepted that materiel committed to infrastructural development was brought by the Claimant to Albania and lost there… There is no need to use one's imagination to list the possible risks associated with the Contracts; one need only consider what actually happened. The Contracts envisaged aggregate remuneration to the Claimant of some US$7 million. The expectation of a commercial return is self-evident.'*[72]

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[69] *Saipem v Bangladesh.* Decision on Jurisdiction. para. 111.

[70] *Ibid.* para. 102.

[71] *Ibid.* paras. 105-111.

[72] ICSID, "Pantechniki S.A. Contractors & Engineers v. Republic of Albania(ICSID Case No. ARB/07/21)." Award of 30 July, 2009. paras. 48&49. (hereafter, *Pantechniki v Albania*)

In *Toto v Lebanon*, the dispute arose from a construction contract, to construct the Arab Highway. Lebanon argued that the contract is simply a commercial sale of goods and services as the contractor's remuneration is guaranteed and covers profits, costs and risks.[73] The Claimant argued that exorbitant clauses, such as variation, warranty or retention money is present in the case.[74] The Tribunal found that *"…the risk stems from the nature of the contract and, as stated in Salini v. Morocco, does not require that the investor be "linked to the exploitation of the completed work. A construction contract in which the execution of the works extends over a substantial period of time involves by definition an element of risk. The duration of the contract is a determining factor with regards to the magnitude of the risk since the exposure to changes and unexpected occurrences increases in proportion to the duration of the contract."* [75] The Tribunal refused the argument that the risk is covered by a 'guarantee payment' by referring to Saipem v Bangladesh. It found that '*...there is no guarantee that the price paid by Lebanon, the employer, will be sufficient to cover the actual costs of the contractor for the performance of its obligations, especially since many unknown factors might intervene'*.[76]

In *ATA v Jordan*, the dispute concerned the validity of the annulment by Jordanian Courts of an arbitral award rendered following a dispute arising from the collapse of a dike constructed. The Jordanian Court of Appeal extinguished the arbitration agreement.[77] While the Tribunal examining jurisdiction on the basis of *rationae-temporis* it emphasized that "…*an investment is not a single right but is, like property, correctly conceived of as a bundle of rights, some of which are inseparable from others and some of which are comparatively free-standing.'* [78] By referring to *Saipem v Bangladesh* case the Tribunal said that the Tribunal therein considered that the "entire operation" including the underlying *"…Contract, the construction itself, the Retention Money, the warranty and the related ICC Arbitration" was an investment under*

[73] ICSID, "Toto Costruzioni Generali S.p.A. v. Republic of Lebanon(ICSID Case No. ARB/07/12)." Decision on Jurisdiction. paras. 72-74. (hereafter, *Toto v Lebanon*)

[74] *Ibid.* paras. 70-71.

[75] *Ibid.* para. 78.

[76] *Ibid.* para. 86-b.

[77] ICSID, "ATA Construction, Industrial and Trading Company v. Hashemite Kingdom of Jordan(ICSID Case No. ARB/08/2)." Award of 18 May, 2010. para. 35. (hereafter, *ATA v Jordan*)

[78] *Ibid.* para. 96.

Article 25 of the ICSID Convention.' was investment under Article 25 of the Convention.[79] The Tribunal accordingly stated that *'the right to arbitration is a distinct "investment".*'[80]

In *Alpha v Ukraine*, the dispute arose from a contract for the reconstruction and renovation of a hotel. The Tribunal found that the activities took place over an extended period of time. The activities, the Claimant's commitment of capital, and the terms of the relevant contracts all extended for many years and the Claimant contributed for a sufficient duration. For the risk, the Tribunal said that *'...Claimant was investing in Ukraine at a time of great political, legal and commercial uncertainty... The fact that Claimant was to receive a fixed minimum monthly payment does not undermine the finding that Claimant assumed substantial risk... The minimum monthly payments were, perhaps, designed to offset at least some of the risk involved... The fact that a party is owed a fixed amount by the terms of a contract does not mean that all risk for that party has been eliminated, as the risk of default may remain at elevated levels.'* Consequently the Tribunal found that '*...Removing all fixed payment contracts from the scope of investment protection would lead to a substantial loophole in the ICSID Convention, and Respondent has provided no convincing evidence that this was the intent of the drafters."* [81]

In *Malicorp v Egypt,* the Claimant entered into a construction contract for the construction of the Ras Sudr International Airport. The Parties ended the relationship without any significant contribution was made. However, the Tribunal found that the activities qualify as investment by stating that "…*there is nothing per se to prevent the view that the long-term contractual commitment of a party to thereafter perform services fulfilling traditional criteria also amounts to a contribution…."* [82] The Tribunal examined "contribution" and stated that in case of a contract the costs incurred during the negotiations do not constitute an investment if the Parties do not sign a contract. Stating that the Contract was signed between the Parties the Tribunal found that: "…*the fact of being bound by that Contract implied an obligation to make major contributions in the future. That commitment constitutes the investment; it entails the promise to make contributions in the future for the performance of which that party is henceforth contractually bound. In other words, the protection here extends to deprivation of*

[79] *Ibid.* para. 114.

[80] *Ibid.* para. 117.

[81] ICSID, "Alpha Projektholding GmbH v. Ukraine(ICSID Case No. ARB/07/16)," Award of 8 November, 2010. para. 323. (hereafter, *Alpha v Ukraine*)

[82] ICSID, "Malicorp Limited v. Arab Republic of Egypt(ICSID Case No. ARB/08/18)." Award of 7 February, 2011. para. 111. (hereafter, *Malicorp v Egypt*)

the revenue the investor had a right to expect in consideration for contributions that it had not yet made, but which it had contractually committed to make subsequently.[83]

In *Tulip v Turkey*, the Tribunal found that the Claimant made an investment when it acquired shares in Tulip I, which was a party to the construction contract with Emlak, for the construction of a real estate development project.[84] The Tribunal emphasized that an indirect shareholding in a local vehicle may form the basis for an "investment." [85] The Tribunal qualified the loan facility agreements and other expenditures, such as direct out-of-pocket expenses, as investment for the purpose of Article 25 by stating that its overall investment included various infusions of capital into the project.[86]

In *Ickale v Turkmenistan*, the Claimant entered into fifteen different construction contracts in Turkmenistan, including the construction of dam projects, drinking water and sewage system projects, and hotel and residential building projects. The Respondent argued that the contracts are free-standing construction lacking investment risk and do not entail contributions. It also argued that the activities did not contribute to the Respondent's economic development.[87] The Tribunal said, however, that it cannot be inferred from the Preamble of ICSID Convention, which refers to *"the need for international cooperation for economic development, and the role of private international investment therein"*, that each and every activity must, on its own, make a significant or measurable contribution to the development of the economy of the host State. The Tribunal, by adopting *Saipem v Bangladesh*'s 'the entire operation' approach, found that contribution is a role of the investment as a whole. It added that *'…the Preamble … refers to the activity of private international investment as a whole…The evidence also shows that the Claimant has committed significant assets of its own, in the form of money, machinery and equipment, to perform the Projects. In the circumstances, the Tribunal does not find it appropriate to consider each of the Contracts concluded by the Claimant individually when determining whether the Claimant has made an "investment" in Turkmenistan; they form part of a whole, which is the Claimant's business venture in Turkmenistan. In view of the scale,*

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[83] *Ibid.* para. 113.

[84] The BIT clause refers to *"…shares of stock or other interests in a company or interests in the assets thereof."*

[85] ICSID, "Tulip Real Estate Investment and Development Netherlands B.V. v. Republic of Turkey(ICSID Case No. ARB/11/28)." Award of 10 March, 2014. para. 200. (hereafter, *Tulip v Turkey*)

[86] *Ibid.* paras. 203-204.

[87] ICSID, "Ickale Insaat Limited Sirketi v. Turkmenistan(ICSID Case No. ARB/10/24)." Award of 8 March, 2016. paras. 268-271. (hereafter, *Ickale v Turkmenistan*)

duration and number of the projects, and the commitment of capital …the Claimant must be considered to have made an "investment" in Turkmenistan..."[88]

In *Garanti Koza v Turkmenistan*, the Claimant had entered into a contract, for the designing and construction of 28 highway bridges and overpasses on a reconstructed highway. The Respondent argued that the contract is simply sale contract, since it does not contain risk as it provided for progress payment to be made as the work progresses. [89] The Tribunal referred to *Bayindir v Pakistan* wherein the Tribunal observed that: *"The construction of a highway is more than construction in the traditional sense;"* since it *"'implies substantial resources during significant periods of time'" and "'clearly qualifies as an investment*."[90] The Tribunal further found that:*"…For what it is worth, Garanti Koza devoted activity to making that investment, for as long as its efforts continued, and it left behind a number of bridges that are being used by the Respondent today."*

After determining that Garanti-Koza had an investment within the meaning of the BIT the Tribunal found that it also has investment under Article 25 as the definition in the BIT or the nature of the investment do not exceed what is permissible under the Convention.

In *Beijing Urban v Yemen*, the dispute arose out of a construction for the construction of the Sana'a International Airport. The dispute was about unlawful deprivation of the investment by the Respondent and the Respondent claimed that the Claimant was purely a paid construction contractor that had to provide a performance guarantee. [91]

The Tribunal found that: *"The contribution, when the Salini test is applied, need not only be financial; some tribunals have held that it can mean a transfer of know-how or of equipment derived from the dedication of resources which themselves have an economic value.*[92] *To the extent to which it may be necessary or useful to apply the Salini test, that contribution clearly exposed BUCG, a foreign investor, to risks posed by the sovereign power and otherwise as*

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[88] *Ibid.* paras. 291-293.

[89] ICSID, "Garanti Koza LLP v. Turkmenistan(ICSID Case No. ARB/11/20)." Award of 19 December, 2016. para. 160. (hereafter, *Garanti Koza v Turkmenistan*)

[90] *Bayindir v. Pakistan*, Decision on Jurisdiction. para. 128.

[91] ICSID, "Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen(ICSID Case No. ARB/14/30)." Decision on Jurisdiction. para. 122. (hereafter, *Beijing Urban v Yemen*)

[92] *Ibid.* para. 132.

described in Salini itself: with regard to the risks….[93] The Tribunal also addressed the risk element and referred to *Toto v Lebanon* and found that *"…a construction contract in which the execution of the works extends over a substantial period of time involves by definition an element of risk… It is obvious that construction of an international air terminal worth in excess of a hundred million dollars contributes to the host State's economic development."*[94]

2.5 Assessment of the case law

Construction contracts seem to meet the criteria required to be considered as investment. Where a treaty itself defines a construction activity as investment, as in 2012 U.S. Model BIT, it is easier for a tribunal to define the activity as investment. In cases where there is no open mention, the Tribunals made broad interpretations and found that construction contracts constitute investment.

2.5.1 Some mentioned specifies of construction contracts

By finding so, the Tribunals referred to characteristics of construction contracts that distinguish them from other contracts and perhaps constitute Salini criteria. Some of these are explained below by using some clauses in one certain template construction contract, *i.e.* General Conditions of Contract of FIDIC (hereafter will be mentioned as 'FIDIC'), which is highly used in construction practice, to demonstrate how such characteristic helps to form a criterion. The ones to be analyzed are right to terminate, right to variate, extensions, warranty period, mobilization advance, pre-tender stage, retention money, the engineer.

In *Salini v Morocco* and *Consortium RFCC v Morocco*, where the Tribunal discussed the risk element of the contract it mentioned some specific risks, *i.e.* prerogatives of the Owner to end the Contract, the Owner's right to variate.

- **Right to terminate**

Sub-Clause 15 of FIDIC stipulates the conditions where the employer has the right to end the contract. Some scenarios in FIDIC where the employer can end the contract are; the contractor's failure to comply with a notice to correct, failure to reach production outputs, failure to remedy defects, some optional termination clauses etc.[95] In practice number of the conditions

[93] *Ibid.* para. 136.

[94] *Ibid.* para. 137.

[95] Ellis et. al., *FIDIC Contracts, Law and Practice*, para. 8.159.

is increased by inclusion of new scenarios. Moreover, as provided in Sub-clause 15.5 of FIDIC, construction contracts give an employer the right to terminate the contract *'for his convenience'*. Thus, the employer shall entitle to terminate contract at any time for any reason, whether financial, political or otherwise, though the contractor is not at fault.[96] Such margin creates a risk for contractor and the Tribunal observed this.

- **Right to variate**

Employer has the right to vary the works under the contract generally before issuing taking-over certificate. Sub-Clause 13 of FIDIC sets forth the employer's right to vary wherein the employer is entitled to initiate a variation through the engineer, a third party appointed by the employer and acts for the employer. In practice, decisions for detailed specifications of the works are made after the contract is awarded in accordance with the changes in the employers' needs. Without such right contractor would have to agree to a change in separate agreement every single time. Since this is not always achievable, it is very common that construction agreements have such clauses.[97]

Variations can have, in practice, time and cost implications. Upon receipt of an instruction for a variation contractor can submit cost and extension of time claim to eliminate the risk of not being able catch the project until the hand-over date with the fixed contractual price. However, there arises disputes as to whether such instruction constitutes a variation and the contractor's entitlement to time and money.[98] Moreover, such claims are evaluated by the engineer, an actor employed by host state, and this brings about the impartiality issues. This creates a certain risk for contractor.

In *Consortium LESI v Algeria,* for the duration criterion the Tribunal referred to justified extensions and warranty period.

- **Extensions**

Interface issues and variations can have time impact, which requires extension. In addition, in construction sector starting from commencement of the works, *i.e.* mobilization to site, to handing-over of the project almost entire activities are subject to approval of the employer or the engineer. This includes, among the others, material to be used, method of installation to be

[96] *Ibid.* para. 8.163.

[97] *Ibid.* para. 3.285.

[98] *Ibid.* para. 3.289.

adopted, designs to be followed or suppliers from which a material to be provided. Since all the activities have to be approved in advance by the employer, or the engineer employed by the employer, any delay in examination of the contractor's submissions would delay the project. Moreover, where design is not the contractor's responsibility any late issuance of, or fault in, design would significantly delay a project on account of the issues not attributable to contractor. In these cases, contractor would be entitled to be granted justified extensions. Moreover, in geological and meteorological difficulties and force majeure situations the contractor could be entitled extensions. Therefore, not only contractually agreed time but also extensions are counted in the duration period.

- **Defects Liability / Warranty Period**

Another concept which makes the duration longer than contractually agreed and increases the risk is defects liability period. This is *'... a set period of time after a construction project has been completed during which a contractor has the right to return to the site to remedy defects.'* [99] As per Sub-Clause 11 of FIDIC, the contractor *'...shall complete any work which is outstanding on the date stated in a Taking-Over Certificate, within such reasonable time'* at its own risk and cost. In practice, the duration of this period lasts at least 1 year. [100] Thus, this period increases both the duration of the contract and the risk without against payment.

In *Bayindir v Pakistan,* regarding the duration criterion the Tribunal adopted an approach similar to the Tribunal's in L.E.S.I v Algeria. As regards the risk criterion the Claimant contested that it assumed a considerable risk by securing first demand bank guarantees since it submitted two bank guarantees to secure the Mobilization Advance.

- **Mobilization advance**

It is common to give an advance payment to contractor to assist it with its cash-flow at the beginning of project.[101] When an employer agrees on giving a mobilization advance, however, it is not usual that it releases the advance without and before a bank guarantee is provided in the same amount of the advance payment. In practice, contractor is requested to provide a bank guarantee as well as the Performance Guarantee.[102] As it was the case in *Bayindir v Pa-*

[99] Out-Law, "Defects Liability Period."

[100] *Ibid.*

[101] Ellis et. al., *FIDIC Contracts, Law and Practice,* para. 7.185.

[102] *Ibid.* para. 7.187.

kistan this guarantees are payable to beneficiary, *'...on his first demand'.*[103] So it is difficult to argue that advance payment reduces the risk since contractor in return has to submit a security, which is above the advance payment, to employer in the form of bank guarantees.

In *Jan de Nul v Egypt*, the Claimant argued that pre-tender stage should also be counted in duration and the Tribunal found the duration sufficient.

- **Pre-tender and tender stage**

A contractor may have to make expenses before a project being awarded. This is especially the case if the contractor is responsible for the designs of the work. It then has to employ staff and prepare a bid prepared as per the specific requirements of the employer. Once contract is signed and contribution starts to flow to the host state pre-contractual stage may also be, and in this case was, included when calculating the duration of the investment.

In *Saipem v Bangladesh*, regarding the risk the Tribunal referred to retention money.

- **Retention Money**

Retention money is another concept of construction contracts. It is described as '*...the sum of money held by the employer as a safeguard for any defective or non-conforming work by the contractor. Retention money safeguards the employer by defects which can occur during the defects liability period if the contractor doesn't response according to the contract terms.* '[104] It is articulated almost in all construction contracts, including FIDIC. As per Sub-Clause 14.9 of FIDIC, some portion of the Retention Money is paid to contractor at the end of Defects Liability Period. The practice of holding a percentage of the sums already payable as security for completion of the whole of the works is common both in continental Europe and common law countries.[105] The concept increases the risk the contractor assumed.

In *ATA v Jordan*, one of the issued discussed was who was responsible for the collapse of a dike, *i.e.* the engineer or the contractor. Engineer is another concept of construction contracts.

- **The Engineer**

As per Sub-Clause 3 of FIDIC: *'The Employer shall appoint the Engineer who shall carry out the duties assigned to him in the Contract. The Engineer's staff shall include suitably quali-*

[103] *Bayindir v Pakistan*, Decision on Jurisdiction. para. 8.

[104] The Contracts Engineer, "What is Retention Money in Construction Contracts."

[105] Ellis et. al., *FIDIC Contracts, Law and Practice*, para. 7.217.

fied engineers and other professionals who are competent to carry out these duties.' The engineer works in the capacity of a-agent of the employer, *i.e.* the state, b-impartial quasi-judicial decision maker. It can be argued by a state therefore that appointment of an engineer actually reduces the risk of a contractor since contractor can recourse to an impartial body. This argument is not, as per my opinion, valid, however, since it is unilaterally appointed by the employer, has contract with the employer and is being paid by the employer. Thus, it is not realistic to expect an engineer to make a decision for the benefit of the contractor which would in return be in detriment of the employer.[106] On the contrary, as all the submissions of contractor go through the approval of engineer and employer this may extend the project duration, thereby creates a certain risk for contractor.

2.5.2 'Entire Operation' as an investment

In *Saipem v Bangladesh* and *Ata v Jordan*, the Tribunals accepted that there is an investment by looking at 'the entire operation' that includes the Contract, the construction, the Retention Money, the Warranty. Though did not specifically mentioned some Tribunals seem to have adopted this approach since they refused some individual elements as investment. In *Joy Mining v Egypt*, for example, the Tribunal found that the guarantee letter provided for the performance of the works is not an investment since it is a contingent liability and accepting that contingent liability as an asset would go beyond the scope of the investment.[107] This approach has however not, as stated in *Beijing Urban v Yemen*, been universally accepted.[108]

Similarly, in *Malicorp v Egypt*, the Tribunal examined whether the cost incurred before entering into agreement can be qualified as investment and answered it negatively. The same is discussed in *Mihaly v Sri Lanka* and also answered negatively.[109] The Tribunal stated that the expenditure may be retrospectively considered as part of an investment had the parties entered into agreement after the negotiations. Consequently, construction companies may have to make expenditures during the tender or pre-contractual stage but this may not be deemed as investment should the parties not enter into a contract.

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[106] Contractormag, "Is there a perfect engineer?"

[107] ICSID, "Joy Mining Machinery Limited v. Arab Republic of Egypt(ICSID Case No. ARB/03/11)." Award of 6 August, 2004. paras. 42-63. (hereafter, *Joy Mining v Egypt*)

[108] *Beijing Urban v Yemen*, Decision on Jurisdiction. para. 127.

[109] ICSID, "Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka(ICSID Case No. ARB/00/2)." Award of 15 March, 2002. paras. 46-51. (hereafter *Mihaly v Sri Lanka*)

3 CHAPTER III- ATTRIBUTION

3.1 Introduction

To bring claim before investment arbitral tribunals, an alleged breach must be attributable to the host state since investment treaties do not cover commercial disputes. Within ICSID framework, the jurisdiction is established if the dispute arises between a Contracting State and a national of another Contracting State. Moreover, a State conduct that goes beyond an ordinary contracting partner is required. The Tribunal in *Impregilo v Pakistan* found that: *'In order that the alleged breach of contract may constitute a violation of the BIT, it must be the result of behaviour going beyond that which an ordinary contracting party could adopt. 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.*'[110]

The study will now turn to the question of attribution in the context of construction contracts in investment arbitration. This is of particular importance because states are, through their entities, enter into contractual relation with contractors. The contractual arrangement between the parties are private, however, in construction contracts the nature of the construction investment generally involves public interest, which makes the contracts open to misuse of public power for political motives. Thus, there arises question whether an act, that is alleged to breach IIA, is taken within the sovereign authority of the State or is it simply an act that any commercial party could take.

To speak about a State responsibility three elements- attribution, breach, and the absence of any valid justification for non-performance- is required as per Article 2 of The International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts (ILC Articles). [111] This chapter will, however, only deal with the attribution issue since the purpose is to identify the specificities of state-owned entities and their acts as contractual partners in investment arbitration context.

[110] ICSID, "Impregilo S.p.A. v. Islamic Republic of Pakistan (II) (ICSID Case No. ARB/03/3)," Decision on Jurisdiction. para. 260. (hereafter, *Impregilo v Pakistan*)

[111] Crawford, Olleson, "The nature and forms of international responsibility," 454.

3.2 Attribution in international investment law

As per Article 1 of ILC Articles, breach of an international obligation by a state brings international responsibility.[112] Though there is a distinction between tort, crime or contract liability in national laws, international law does not make such distinction. The States are responsible not only for general obligations of international law but also for breach of treaty obligations. The Tribunal said in *Rainbow Warrior* case that *'...the general principles of International Law concerning State responsibility are equally applicable in the case of breach of treaty obligation, since in the international law field there is no distinction between contractual and tortious responsibility, so that any violation of a State of any obligation, of whatever origin gives rise to State responsibility.'*[113] Thus, ILC Articles provide guidance on attribution in investment arbitration.

State-owned entities play an important role in some sectors including construction.[114] They enter into agreements with foreign investors to make them participate in businesses. When a breach of agreement is occurred investor seeks to redress directly to the host state. This arises question as to which extent conduct of entities can be attributable to the State.

Of course, investors' motivation to address their claims to state is understandable due to a-they wish to submit the dispute to the Centre which requires the dispute to be submitted against a Contracting State b-State-owned entity may not have sufficient resources to meet the award.[115] The State will in turn probably deny that the Centre has jurisdiction since the entity enjoys its own legal personality.

Although states argue that ILC Articles are not applicable investor-state disputes, it has been accepted that even if the actions are not attributable under Article 4, they can nevertheless be on the basis that the entity exercises either governmental authority under Article 5 or acts under instruction, direction or control of the State under Article 8.[116]

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[112] Crawford, Olleson, "The nature and forms of international responsibility," 446.

[113] UN, "Rainbow Warrior case *(France/New Zealand)."* para. 72-75.

[114] State-owned entity can be fully, majority or minority owned by state. They take the form of regular private entities and subject to same legal regulations.

[115] Feit, "Responsibility of the State under International Law for the Breach of Contract Committed by a State-Owned Entity," 143.

[116] Olleson, "The Impact of the ILC's articles on Responsibility of States for Internationally Wrongful Acts," 17. Also Hober, "State Responsibility and Attribution," 553.

3.2.1 Article 4

As per Article 4 of ILC Articles, a state is responsible for acts of all its organs including those exercise functions in territorial units such as provinces and municipalities. [117] It is unimportant for attribution purpose that '*…the conduct of a State organ may be classified as 'commercial' or as 'acta jure gestionis'*[118] The attribution arises though the act is *ultra vires* in the exercise.[119]

3.2.2 Article 5

Where investments are handled by state-owned entities, pleadings are raised that the acts of entities are not attributable to state. The issue is also relevant when a state argues that claimant is a state-entity rather than a national of another state. But, this part will not deal with the latter since that corresponds to whether the Claimant is an investor rather than attribution.

Acts of state-entities are principally not attributable to states. However, there are exceptions to this rule, *i.e.* a-in instances where corporate veil is formed for the purpose of fraud b-state-entity is empowered and acting in governmental capacity in the particular instance.[120] I will deal with the latter since under the former the contract itself is attributed to the State.

Article 5 of ILC a state is responsible for conduct of a person or entity empowered by the State. In finding attribution, two-tier test is applied; whether a-state entity exercise governmental authority, b-the particular act in question is exercise with governmental authority.

Where tribunals do not find attribution under Article 4, they carry out functional test under Article 5 and analyze whether the act in question is commercial or governmental in nature. The Tribunal in *Maffezzini v Spain*, for example, said that by examining whether SODIGA's actions, a public-entity, it will categorize the acts disputed, and concluded that actions are partially commercial and partially governmental in nature. Thus, the Tribunal found that those acts that are in governmental nature can be attributable to Spain.[121]

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[117] Crawford, *The International Law Commission's Articles on State Responsibility*, 95.

[118] UN, "Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries," Article 4, para. (6).

[119] Dolzer, Schreuer, *Principles of international investment law*, 217.

[120] ICJ, "Belgium v Spain, Barcelona Traction, Light and Power Company, Limited." paras. 56–58.

[121] ICSID, "Emilio Agustín Maffezini v. The Kingdom of Spain(ICSID Case No. ARB/97/7)." Award of 9 Novermber, 2000. paras. 52-73. (hereafter, *Maffezzini v Spain*)

3.2.3 Article 8

Article 8 of ILC Articles articulates the attribution of a conduct to a state in cases where a persons' or group of persons act on the instruction, direction or under the control of the State.[122] Although private acts are not attributed to states, in this circumstance the attribution will be in question. The formulation in the Article was a conscious choice of the Commission adopted the approach[123] of Nicaragua case: *For this conduct …to give rise to legal responsibility of the United States, it would in principle have to be proved that that State had effective control of the military or paramilitary operations in the course of which the alleged violations were committed.*[124]

For attribution under Article 8, it does not matter whether the acts are commercial, contractual or governmental.

3.3 Fundamental concerns

The most distinguishing character of construction contracts in this context is perhaps the nature of the activities. It is true that contracts, including construction contracts, are arrangements between parties acting in private capacities and, thus, private in nature. A state entity can argue, therefore, that the subject activity is merely commercial. But, it is also true that the construction activities serve public interest. Contractors assume duties that public authorities traditionally provide. In *Salini v Morocco*, the Tribunal said that infrastructure works, which are construction activities, are state's obligation and the project shall serve public interest.[125] This character makes the construction activities open to political interference. Therefore, the nature of the activity suggests that state entity's act can be more than an act of an ordinary commercial counter-party. The act can seemingly be taken with commercial purposes with the State's contractual counter-party capacity whereas the real stimulating reason for such conduct can stem from political motives. Moreover, since public power or the governmental authority is undefined in ILC Articles and depends on the history and definition of the state as well as other factors,[126] a Respondent State can easily clothe a governmental act and present it

[122] Muchlinski, "Corporations in International Law," para. 48.

[123] Olleson, "The Impact of the ILC's articles on Responsibility of States for Internationally Wrongful Acts," 82.

[124] ICJ, "Military and Paramilitary Activities in and against Nicaragua, Merits, Judgment(Nicaragua v United States of America)", para. 115.

[125] *Salini v Morocco*, Decision on Jurisdiction. para. 57.

[126] Hober, "State Responsibility and Attribution," 556.

as commercial. In *Jan de Nul v Egypt*, a construction contract was signed with SCA, a state-owned company, for widening, deepening and maintenance of the Canal. The Tribunal rejected the attribution of the acts of SCA to the State, as they are commercial in nature rather than governmental. However, as Petrochilos said, *'...One wonders if maintaining a country's major waterway – and one which is in fact so important as to be governed by a multilateral international treaty– can really be said to be a plain-vanilla commercial activity'*. [127] This public interest nature of construction activities also closely linked with the substantive protection of the investment, which shows that attribution has relevancy for substantive protection as well as jurisdiction purpose.

Secondly, state-entities or companies are generally established as a distinct autonomous body to carry out one particular type of construction activity. A state-entity that deals with highways and an entity that deals with sewer system or airport terminals may be, and generally are, different specialized entities. Contractors enter into contracts with these specialized distinct autonomous state-entities. Once specialization increases and contractual-counter party distinguishes itself and moves away from central governmental structure the attribution is harder to be found since the *prima facie* case/argument is that the specialized state-entity acts as an ordinary commercial corporation and takes decisions for its utmost commercial benefits. Put differently, the specialized entities act in commercial private party capacity as fit the purpose of its creation. In *Tulip v Turkey*, where state company Emlak, entered into a construction contract with the Claimant, the Tribunal said that the acts are not attributable to the State since Emlak is set up to operate commercial undertakings and the fact that majority ownership is held by the State does not change this and it does not hold governmental authority. In *Impregilo v Pakistan*, where a contract was signed with WAPDA, a State entity, the Tribunal stated that the acts are not attributable to the State since WAPDA is *'properly characterized as an autonomous corporate body, legally and financially distinct from Pakistan.'*[128], despite the fact the Tribunal accepted that Pakistan exercises a strict control on WAPDA. This may make it possible for states to clothe company or insulate the entity from the State, thereby create veils to prevent claims from bringing against them.

Also Crawford, *The International Law Commission's Articles on State Responsibility*, 101.

[127] Petrochilos, "Attribution of Conduct of Non-State Organ Entities: An Introduction," 359-360.

[128] *Impregilo v Pakistan*, Decision on Jurisdiction. para. 209.

The same issue arises where construction contract is entered into with a state organ distant from the central government. In *Bosh v Ukraine*, the Claimants entered into a construction contract with the Taras Shevchenko National University of Kiev to undertake a two-stage renovation and redevelopment of a property. The University is funded, supervised by the State and its main function is to provide higher education that can only be exercised by State institutions. However, the Tribunal said that it could not agree that the University is a State organ.[129] This is perhaps a conceptual concern, which arises due to the absence of definition of state organ.[130]

3.4 Case law

The study now turns to the case law as to construction contracts where attributability is discussed. For convenience, the cases will be divided into two parts, *i.e.* where attribution is accepted and where refused. They will be given in chronological order.

3.4.1 Where the act is attributable to state

In *Amco v Indonesia*, the Claimant signed contract with PT Wisma, an Indonesian company operating under the guidance of the government of Indonesia, for construction of a hotel&office complex. PT Wisma forcibly took over the control of the project with the help of the Indonesian armed forces and Amco's license to engage business activities is invoked. The Tribunal said that PT Wisma's close relationship with army does not make its acts attributable to Indonesia but lack of protection and assistance does.[131]

In *Salini v Morocco*, the Tribunal said that Morocco holds at least 89% of ADM through the medium of the Treasury and various public entities and it cannot be denied that ADM is an entity controlled and managed by the Moroccon State. As an evidence, the Tribunal mentioned the Minutes of the Board of Director's Meeting, to which the Minister of Infrastructure etc. attended. The Tribunal also said that it is clear that ADM's main object is to accomplish tasks that are under State control. Hence, the Tribunal found that ADM is a State company acting in the name of Morocco.

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[129] ICSID, "Bosh International, Inc. and B&P, LTD Foreign Investments Enterprise v. Ukraine(ICSID Case No. ARB/08/11)." Award of 25 October, 2012. para. 163. (hereafter, *Bosh v Ukraine*)

[130] Petrochilos, "Attribution of Conduct of Non-State Organ Entities: An Introduction," 353.

[131] BIICL, "Amco Asia Corporation and others v. Republic of Indonesia,(ICSID Case No. ARB/81/1)." Award of 20 November, 1984. 3-6. (hereafter, *Amco v Indonesia*)

In *Generation Ukraine v Ukraine*, the Claimant engaged in a construction project of an office building with the Kyiv City State Administration. The Tribunal said that conduct of a municipal authority is capable of being recognized as an act of the State. It would have been different issue if the issue was based on an alleged breach of contract in which case the municipality would be the proper party. The distinction is made in *Vivendi* case and there is no difficulty in applying the same in the case present.[132]

In *Salini v Jordan*, the Claimant signed a contract with Jordan Valley Authority(JVA) for the Construction of the Karameh Dam project. [133] The Tribunal said that under Jordanian law the JVA is distinct from the State and thus it is to be said that Jordan might not be held responsible for JVA's breaches of contract. A State, however, may be held responsible for the acts of local public authorities or public institutions under its authority and, hence, Jordan may be held responsible for the acts of the JVA.

In *Consortium LESI v Algeria*, the Tribunal said that the Contract was signed by ANB, an independent agency of the State, but the Tribunal cannot exclude a priori involvement of the State which participated in the negotiations of the contract and had important, perhaps determining, influence over the agency. The Tribunal considered the possible involvement of the State and found that the dispute arose between the Claimant and the State.[134]

In *Parkering v Lithuania*, the Claimant entered into contract, through its wholly-owned Lithuanian subsidiary Baltijos Parkingas UAB(BP), with the Vilnius Municipality for construction of public parking system in the City of Vilnius. The Tribunal stated that the contract was entered into by two different entities, *i.e.* BP and the City of Vilnius. That the Claimant was not a party to the dispute is irrelevant since claims correspond to Treaty breaches and there is nothing in record that shows that the Claimant disguised contract claims with treaty claims for jurisdiction purpose. The Tribunal said that states are responsible for acts of their agencies for wrongful acts and found that the claims fall under the Treaty.[135]

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[132] ICSID, "Generation Ukraine v. Ukraine(ICSID Case No. ARB/00/9) Award of 16 September, 2003. paras. 10.1-10.7. (hereafter, *Generation Ukraine v Ukraine*).

[133] ICSID, "Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan(ICSID Case No. ARB/02/13)." Decision on Jurisdiction. para. 14 . (hereafter, *Salini v Jordan*).

[134] *Consortium LESI-Algeria*, Award of 10 January, 2005. para. 2.3-c/iii.

[135] ICSID, "Parkerings-Compagniet AS v. Republic of Lithuania(ICSID Case No. ARB/05/8)." Award of 11 September, 2007. paras. 258&259. (hereafter, *Parkering v Lithuania*)

In *Bayindir v Pakistan*, the Tribunal said that the claims asserted are, from contractual point of view, were those of NHA and not of the Government of Pakistan. NHA is a distinct legal personality under the laws of Pakistan and though there may be links between NHA and the government of Pakistan this does not mean that the two are not distinct. Regarding Article 5 the Tribunal said that NHA is empowered to carry out governmental authority, however, it is not persuaded that the evidences proved that in undertaking the actions NHA was acting *'in the exercise of the governmental authority'*. Regarding Article 8, all the claims were based on the NHA's decision to terminate the Contract which received express clearance from the Government. The Tribunal said that the acts are attributable to the Respondent by virtue of Article 8 based on the government's involvement to the Project, particularly at a meeting, where General Musharraf gave clearance to NHA to resort the available contract remedies, including termination. The Tribunal also stressed that it does not matter that the acts are commercial or contractual for the purpose of attribution under Article 8.[136]

In *Toto v Lebanon*, the Tribunal said that the CEPG has a distinct legal personality, enjoys administrative and financial autonomy and had its own budget but operated under Ministry of Public Works and Transport. Based on this, the CEPG was found to be a public entity created to exercise governmental authority and its conducts are considered as act of Lebanon. The Tribunal said that the CDR became the universal successor to the CEPG and it also has a legal personality and enjoys administrative and financial autonomy. The CDR acts autonomously when it plans and programs the tasks that were transferred to it, but also works as an agent of the State. It was found to represent all the public authorities and municipalities in their expropriation prerogatives and to control projects included in general plan and entrusted to it by the Council of Ministers. Its acts are attributed to Lebanon by virtue of Article 5.[137]

In *Alpha v Ukraine*, the disagreement about stopping in payment was as to whether the order to stop the payments given by the State Administration of Affairs(SAA), or by Hotel management. The Tribunal concluded that the SAA instructed the stoppage of the payments as it is a State organ the acts are attributable to the State. The Tribunal said that it was State's conduct caused the Hotel to breach the contract which arises the State's responsibility.[138]

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[136] UN, "Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries", Article 8, para. 2.

[137] *Toto v Lebanon*, Award of 11 September, 2009. paras. 43-60.

[138] *Alpha v Ukraine*, Award of 8 November, 2010. paras. 399-403.

3.4.2 Where the act is not attributable to state

In *Impregilo v Pakistan*, two contracts were concluded between the Claimant and the Pakistan Water and Power Development Authority (WAPDA), for construction of barrage. WAPDA is established by an Act as a body that is *'...entitled to acquire, hold property, shall have perpetual succession and a common seal and shall by the said name sue and be sued.'* After the Tribunal mentioned that Impregilo's argument rested upon principles of state responsibility and attribution, it added that there is a distinction between State responsibility for violation of international law and breaches of municipal law contract. It concluded that the jurisdiction does not extend to breaches of contract entered into with an entity other than the State and since WAPDA is a distinct legal entity, it has no jurisdiction under the BIT. [139]

In *Saipem v Bangladesh*, the Claimant argued that the disputed actions between the parties amount to an illegal expropriation of Saipem's rights to arbitration by combined actions of Petrobangla and the courts of Bangladesh. The Tribunal said that it found no treaty breach in respect to Petrobangla's actions and they are also not official acts of the government in the context of ICC Arbitration and attribution does not arise in connection with Petrobangla.[140]

In *Jan de Nul v Egypt*, the Claimant were under the impression during the performance of the work that SCA concealed some information about the quantities and soil conditions. The Tribunal said that the SCA's acts cannot be attributed to the State within the meaning of Article 4 since it is structurally not an organ of the state. Regarding Article 5, though the Tribunal said that the SCA is empowered to exercise governmental authority, as it can issue decrees and impose and collect charges, the acts that the Claimant complained of were not exercised with governmental authority. For Article 8, the Tribunal said that there is no evidence on record of any instructions that the State would have given to the SCA in regards to the acts complained of and therefore the SCA's acts are not attributable to the State.[141]

In *Bosh v Ukraine*, the Claimants signed a contract with the Taras Shevchenko National University to undertake a two-stage renovation and redevelopment of a property. The Claimants alleged that the contract was terminated due to the conduct of the Control and Revision Office (CRO), the Ukrainian Courts, the Ministry of Justice and the University and that all of these'

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[139] *Impregilo v Pakistan*, Decision on Jurisdiction. paras. 198-216.

[140] *Saipem v Bangladesh*, Award of 30 June, 2009. para. 191.

[141] *Jan de Nul v Egypt*, Award of 6 November, 2008. paras. 155-175.

acts are attributable to the State. The Tribunal said that as per the Respondent's own description CRO is an '*independent financial control authority within the Ministry of finance'* whose duty is to ensure that the entities receiving State funding comply with the requirements of the law. The Tribunal thus found that the CRO's conduct is attributable to the State.[142] Regarding the attribution of the University's acts to the State the Tribunal accepted that the University is empowered by the law to exercise elements of governmental authority, however, the University's decision to enter into and terminate the contract did not relate to exercise of the governmental authority but is a private activity and thus not attributable to Ukraine.[143]

In *Tulip v Turkey*, the Claimant signed a contract with Emlak, a real estate investment trust 39% owned by TOKI, a state organ responsible for Turkey's public housing, for the construction of a real estate project. The Tribunal said that Emlak is pursuing commercial activities. For the argument that majority ownership of an entity by State gives rise to a statehood as stated in *Salini v Morocco* case, the Tribunal said that it is not bound by this decision and there is no international law rule for such presumption. The Tribunal found no attribution under Article 5 since the evidence brought does not establish that Emlak is empowered to exercise elements of governmental authority. Regarding Article 8, the Tribunal said that the acts are not attributable as it is not satisfied that the 'instruction', 'direction' or 'control' is formed. The main contention was that Emlak acted under the control of TOKI. The Tribunal said the relevant enquiry is *'whether Emlak was being directed, instructed or controlled by TOKI with respect to the specific activity of administering the Contract with Tulip JV'.* For the Tribunal, the decisions are taken by Emlak for commercial reasons occurred after the signing.[144]

In *Sergei Pugachev v Russia*, the dispute arose out of investment contracts between the Claimant's company OOO Middle Trading Rows (STR) and state enterprise with the name 'Kremlevskiy' created for this purpose. In the interim award, the Tribunal said that the evidence submitted are, *prima facie,* not sufficient to show that DIA and IIB are synonymous to the Respondent. The Tribunal stated, however, that it will consider this issue once the Parties submit further evidence and allegations.[145]

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[142] *Bosh v Ukraine,* Award of 25 October, 2012. paras.145-147.

[143] *Ibid.* paras. 173-177.

[144] *Tulip v Turkey,* Award of 10 March, 2014. paras. 276-328.

[145] UNCITRAL, "Sergei Viktorovich Pugachev v. The Russian Federation." Award of 7 July, 2017. paras. 234-235. (hereafter, *Sergei Pugachev v Russia*)

3.5 Assessment of the case law

The case law reveals that there is not well-established jurisprudence. In contrast, it reflects an inchoateness since the Tribunals have issued different awards for cases containing similar factual backgrounds. In *Salini v Morocco* the Tribunal accepted that the structural control as State Treasury owned majority shares of ADM, whereas the Tribunal in *Tulip v Turkey* did not find the same enough for attribution. Similar conflict is seen between *Bayindir v Pakistan* and *Impregilo v Pakistan* for the attribution of the acts of autonomous corporate body.

The Tribunal in *Maffezini* case distinguished the acts into two parts, commercial and governmental in nature and found that those acts that are in governmental nature can be attributable to Spain. Although this case did not arise out of construction contract, a similar approach can be taken in disputes regarding construction contracts. Claims commercial in nature, *e.g.* late issuance of money, are thus not easy to be attributable to state, whereas taking of the construction project would be attributable since it is governmental in nature.

International jurisprudence shows that finding attribution under Article 4&5 is demanding since entities are structurally distinct from the state and second leg of the two-tier test in function based attribution is hard to prove, i.e. that the act is taken in governmental capacity. Thus tribunals can find attribution under Article 8 since under this rule it does not matter the acts are commercial, contractual or governmental.[146] Where any proof is found that shows state instruction, direction or control is involved, then tribunals find attribution without looking into the nature of the involvement. In *Bayindir v Pakistan*, the Tribunal found no attribution under Article 4 & 5, but, found under Article 8 since the statements and evidences demonstrate that government involved in the decision of termination of the construction contract.

It is normal to assume that difficulties will continue as there is not an established jurisprudence.[147] However as Li says considering the policy of protecting the investment *'...the attribution rule should be loosely applied; otherwise sovereign States would simply expropriate through SOEs acting as their agents*.[148]

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[146] UN, "Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries," Article 8. Also Hober, "State Responsibility and Attribution," 563.

[147] Hober, "State Responsibility and Attribution,", 582.

[148] Li, "State-Owned Enterprises in the Current Regime of Investor-State Arbitration," 384. SOEs means State-owned entities.

4 CHAPTER IV - BREACH OF CONTRACT AS BREACH OF TREATY

4.1 Introduction

The study now turns to the substantive protection of the investment within the context of construction contracts. Construction contracts are commercial commitments on the part of States and, thus, typical private law contractual arrangements. The activities, on the other hand, serve public interest. Considering that insofar as a breach of contract implicates an established components of the core standard of treatment an investor has an arguable claim,[149] it is important to identify whether an alleged wrongful act is a contractual breach of a party to a private law contract, or is an act that constitutes a breach of a treaty standard since the State acts in its sovereign capacity due to the public interest nature of the activity.

4.2 General criteria and fundamental concerns

Substantive claims have to constitute breach of a treaty since international investment law provides protection against the host State's acts or omissions. Mere contractual claims are outside investment jurisdiction. Thus, an alleged breach in a contractual arrangement must be result of an exercise of the State's sovereign authority to constitute a treaty breach.

The main concern with construction contracts is that the types of contracts used between a contractor and a state-entity, in general, are private law contracts used between ordinary private parties. It is normal that these contracts to envisage obligations correspond to those that can be expected from private parties. Since breach of a commercial obligation does not bring about breach of IIA, a contractual violation on the part of the State may not constitute treaty breach due to lack of exploitation of sovereign authority on the part of the State.

Construction contracts and projects are, on the other hand, of public interest. This leads to two issues. First is that the State's acts, seeming as mere contractual breaches, can be an act taken for political reasons which in turn constitute a deprivation of substantive protection and treaty breach. To illustrate, a simple non-payment itself cannot amount to violation of Fair and Equitable Treatment(FET). But, treaty breach can come into picture if there is proof of arbitrariness and bad faith, for political reasons, for such non-payment.[150] The second issue is that contractual obligations assumed by a State in a construction contract may somehow be different from private law contractual arrangements since as an output the investment will serve the

[149] Ho, *State Responsibility for Breaches of Investment Contracts,* 119.

[150] *Ibid.* 121.

public interest. In a highway or road construction project, for example, besides the obligations of an ordinary counter-party, States may also be expected to assume the expropriation of the land necessary for the construction or adjust the zoning plans etc. Finding of a breach of a treaty in the former is troublesome as the parties, in practice, use, substantially, template private construction contracts such as FIDIC. So, it is really hard to prove that a mere contractual breach of these standard private law contract clauses also constitutes a breach of substantive protection. In the latter, though, finding a breach of treaty is easier since these are contractual obligations where a state's obligations entail more than what is expected from an ordinary commercial party.

4.3 Specific issues in light of the case law

In general, there seems to be no difference between construction contracts and other contractual arrangements in relation to the approach of the Tribunals to alleged breach of treaty standards, e.g. Expropriation, FET, Full Protection and Security (FPS), Most Favored Nation (MFN) etc. In other words, the standards adopted for the protection of contractual arrangements other than construction contracts are also applied for the construction contracts for breaches such as non-payment, cancellation, coerced renegotiations etc. Therefore, the study will not show the case law about such issues. Yet there have arisen special issues due to assumption of obligations on the part of the State that entails more than what is expected from an ordinary contractual counter-party due to the nature of the activity.

- **Zoning plans**

Where a State entity is a counter-party, there may be obligations in the contract that the entity has to adjust zoning plans so that the contractor can carry out the construction. Sometimes the host State is belated for such adjustments and other times for urbanization or other purposes, the contract signed has to be re-adjusted. In such cases, the contractors have argued breach of contract constituted as breach of substantive treaty protection mechanisms such as FET.

In *Southern Pacific Properties v Egypt*, the Claimant signed two contracts with Egyptian General Organization for Tourism and Hotels for development of tourist complexes. The projects continued until the Government took measures that had the effect of canceling the projects when antiquities discovered in the project area. The Claimant argued that the actions amounted to expropriation. The Tribunal found that the expropriation was lawful since it was

for public purpose and the Claimant is entitled to receive fair compensation rather than damages for breach of contract. [151]

In *AIG v Kazakhstan*, the Claimant and Kazakhstan Agency on Investment signed a contract to construct a residential housing complex. The project was later cancelled and the property was seized since it was needed for a 'national arboretum' and the contractor is offered alternative sites. The Tribunal found that the cancellation of construction permits and continuous impediments are contrary to procedures established by Kazakhstan Law and the investment was arbitrarily expropriated, though for a public purpose, through 'measures tantamount to expropriation' when practical and economic use of property was lost.[152]

In *MTD v Chile*, the Contract was signed with Foreign Investment Commission(FIC) for construction of a real estate project in Fundo El Principal de Pirque. The existing zoning of the land that the project was to be developed was for agricultural use. The Project was later rejected since it conflicted with existing urban development policy. [153] The Tribunal adopted the standard in *TECMED v Mexico* case wherein the Tribunal said: *'…to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment…'*[154] It found that approval of the project by FIC, which has ministerial membership, gives *prima facie* the investor an expectation that the project is feasible from regulatory point of view. Thus, approval of the project though it is against the urban policy is breach of FET.[155]

In *Tulip v Turkey*, when the Claimant applied for construction permit it learned that there is a dispute pending regarding zoning plans. The Claimant argued that its legitimate expectations and FET are violated, namely; Turkey knew the existence of zoning litigation and failed to

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[151] ICSID, "Southern Pacific Properties (Middle East) Limited *v.* Arab Republic of Egypt(ICSID Case No. ARB/84/3)." Award of 20 May, 1992. paras. 158,159, 183, 212, 214. (hereafter, *Southern Pacific v Egypt*)

[152] ICSID, "AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan(ICSID Case No. ARB/01/6)." Award of 7 October, 2003. paras. 10.3.1-10.3.3 and 10.5.2. (hereafter, *AIG v Kazakhstan)*

[153] ICSID, "MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile(ICSID Case No. ARB/01/7)." Award of 25 May, 2004. para. 80. (hereafter, *MTD v Chile*)

[154] ICSID, "Técnicas Medioambientales Tecmed v. United Mexican States(ICSID Case No. ARB(AF)/00/2)." Award of 29 May, 2003. para. 154. (hereafter, *TECMED v Mexico*)

[155] *MTD v Chile*, Award of 25 May, 2004. para. 166.

disclose this.[156] The Tribunal found that primary source of legitimate expectations are the Contract and pre-contractual representations made via Tender Specifications according to which the Claimant *'...carried out the necessary investigation, that by seeing the location it has learned about the location where the job will be carried out and has learned about all matters…''* The Tribunal thus rejected the claim. [157]

- **Host state's obligation to expropriate**

Similarly, sometimes the host State may have contractual obligations to expropriate some lands to allow contractor to execute the works. Any late or non-execution of such expropriation of the land belong to third parties may bring about alleged breaches.

In *Toto-Lebanon,* the Claimant alleged that the late expropriations of the land needed for the project and failure of timely delivery of the parcels is a breach of Lebanon's obligation to act in a manner promoting and protecting the Claimant's interest obligations to ensure FET. Regarding the former the Tribunal said that the Claimant did not demonstrate that it was hindered by not expropriating all the land needed. Regarding the latter, the Tribunal said that it fails to see how the Claimant could have legitimately expected that parcels be expropriated earlier than they actually were.[158] The progressive expropriation of the parcels was the Respondent's obligation under Article II.03 of Tender documents.[159] Thus the Claimant's these claims are rejected.

- **Build-Operate-Transfer(BOT) Concession Contracts**

BOT contracts give investors a concession to construct, operate and maintain the investment for concession period before the investment is transferred to the host state. They have extensive usage in infrastructure projects and since it is, by definition, highly used by public, the host States tend to interfere to operation fees or construction lands for political other purposes. Among other specificities of these contracts, states generally guaranteeing a minimum income in exchange for contractor to provide the public service on behalf of it. If a state refuses to pay such contractually guaranteed minimum income in time of recession etc., would this breach of contract constitute a breach of treaty?

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[156] *Tulip v Turkey*, Award of 10 March, 2014. para. 377.

[157] *Ibid.* paras. 377-405&407.

[158] *Toto v Lebanon,* Award of 7 June, 2012. paras. 183-194.

[159] *Ibid.* para. 32.

In *Autopista-Venezuela*, which involved a Concession Contract, the Contract provided that the National Executive shall grant one or more guarantee to ensure payment of the Claimant's debts. The Claimant argued the breach to issue guarantee. The Tribunal found that Venezuela breached to issue the guarantee since it gave a representation in the Preamble of the Agreement according to which the parties *'assert and guarantee that their obligations are legal, valid, binding and enforceable.'* By this, Venezuela assumed the risk of illegality of the issuance of any guarantee.[160] The Tribunal also found breach of Contract by refusing to pay Minimum Guaranteed Income.[161]

In *Hochtief-Argentina*, the Claimant signed a Concession Contract with the Respondent for construction and operation of a toll road. It was partly subsidized by the State. The Claimant argued that Argentina failed to pay the subsidies in a timely manner. After the economic crisis Argentina passed emergency law to adopt certain measures that, among the others, affected the toll revenues. The Project then was no longer viable as per the Claimant. Emergency Law and related decree ordered a renegotiation to mitigate the effects of currency devaluation. The Tribunal found a breach of FET due to the failure to restore and redress the commercial balance that was secured by the Contract. It considered that the failure to conclude an agreement on negotiation is a violation of FET.[162]

In *Walter Bau.-Thailand*, the dispute arose from an agreement signed for construction and operation of Tollway for concession period of 25 years. The Tribunal found a breach of FET on account of a-lengty refusal to raise tolls b-roading network changes that went beyond 'traffic management' and c-short-term closure of Don Muang Airport.[163]

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[160] *Autopista v Venezuela,* Award of 23 September, 2003. paras. 131-143.

[161] *Ibid.* para. 178-190.

[162] ICSID, "HOCHTIEF Aktiengesellschaft v. Argentine Republic(ICSID Case No. ARB/07/31)." Award of 29 December, 2014. paras. 209-288 & 336. (hereafter, *Hochtief v Argentina*)
In Salini Impregilo S.p.A. v. Argentine Republic (ICSID Case No. ARB/15/39) (hereafter, *Salini-Argentina)* the dispute arose from the same contract in *Hochtief-Argentina*. The Tribunal decided that it has jurisdiction and the award on merits has not been issued yet.

[163] Italaw, "Werner Schneider, acting in his capacity as insolvency administrator of Walter Bau Ag v. The Kingdom of Thailand (formerly Walter Bau AG (in liquidation) v. The Kingdom of Thailand)." Award of 1 July, 2009. para. 12.44. (hereafter *Walter Bau v Thailand*)

4.4 Assessment

Usage of standard private law construction contracts would naturally give prima facie impression that a contractual breach does not amount to treaty breach. Though the tribunals have adopted same criteria for apparent contractual breach for all investment contracts, it may be harder for a contractor to prove that such criteria are formed, *i.e.* the act is taken with sovereign power capacity, since the clauses of the contract and obligations are similar, maybe even same, to those that have been entered into between two private parties due to usage of same template contracts. However, once proven that the act in question relates to sovereign power of the State, the breach can be considered as breach of treaty although the contract is private law contract. Thus, as per my opinion, it is important in construction activities context to make an elaborative examination whether a particular act that is alleged to constitute treaty breach could have public interest nature rather than interest to the state as a commercial counter-party.

It seems that the Tribunals may find treaty breach where states have an obligation to be fulfilled with their sovereign power capacity if a contractor has a legitimate expectation. These categories of contractual breaches, are more likely to implicate recognized components of FET, than breach claims such as non-payment since the latter is typical response to unsatisfactory contractual performance.[164]

[164] Ho, *State Responsibility for Breaches of Investment Contracts,* 138.

5 CHAPTER V - CONCLUSION

FDI investments in construction are increasing. Parallelly, the number of cases related to construction contracts also increases. This was the stimulating point for the study since with this increasing number there may be a hesitation by investors for new projects.

To successfully bring a claim before an arbitral tribunal, first the jurisdiction has to be established. Of course, there are many jurisdictional challenges for investments in the form of contract, such as whether contractor qualifies as investor, or the case has *prima facie* standing. Since nothing was specific to construction contracts, however, I answered the question of *'whether the contract made an investment in the host state?'* I argued that construction contracts with its specific features constitute *Salini* criteria. Though there were several critiques in scholarly writings, I argued that removing all fixed payment construction contracts from the scope of investment protection by disregarding its specificities, cause a loophole in the Convention. I also found that it is pertinent to take those cases where a construction contract shows to form characteristics of investment into the scope investment protection. This approach would be more in line with the spirit of the Preamble of the Convention.

Then the issue of attributability was dealt. The question of *'whether the acts of state entities who are contractual counter-parties to construction contracts can be attributable to the State'* is examined. The case law revealed that there is not well-established jurisprudence on attribution issue and inchoateness will continue. However, I argued that construction projects have public interest in nature and the attribution rule should not be strictly applied since it would give the States to use their sovereignty powers through their entities.

Lastly, the study turned to the question of substantive protection of the investment. It is pertinent to mention that breach of contractual obligations that entails the usage of sovereign powers more likely to constitute breach of treaty since the contracts used in practice are private contracts and, thus, it is hard to prove the involvement of sovereign power on the part of the State. The prima facie argument will be that breach of contract is a typical action that any private party could take.

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