CHAPTER 2

Breach of Treaty Claims and Breach of Contract Claims: Simplification of International Jurisprudence

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I Introduction

One of the ways in which foreign investors invest in a host state is by means of a contract between the foreign investor and an entity or instrumentality of the host state. In numerous cases, disputes between investors and host states under investment treaties arise out of breaches of these underlying contracts. These circumstances have complicated the analysis of investor claims as international tribunals must assess whether claims arising out of contract breaches can rise to the level of a breach of international obligations. The last ten years of arbitration decisions have clarified the proper approach to such issues, which touch on several elements of international law. The decisions on jurisdiction in *SGS v. Pakistan* and *SGS v. Philippines*¹ and subsequent discussions make it clear that a host state’s breach of a private contract might, depending on the nature of the state’s act, also breach the state’s treaty obligations.

Yet, even with this essential principle established, a number of questions still arise. Can an international tribunal hear an investor-state dispute that implicates no true international law obligation and where the only breach is contractual? How does a tribunal distinguish between a breach of contract and a breach of a treaty obligation? How do certain contractual provisions, like a forum selection clause, affect a tribunal’s ability to assert jurisdiction over a claim? This article will discuss the ways in which international tribunals have analyzed these issues at the intersection of contract law and international law.

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II Treaty-Based Tribunals Maintain Jurisdiction over Treaty Claims Arising out of an Underlying Contract

Regardless of whether the facts of the dispute revolve around a contract or some other obligation, a treaty-based arbitral tribunal has jurisdiction over claims asserting a breach of the treaty, assuming that the other jurisdictional requirements are met. The key aspect of the analysis is whether the claimant can assert a violation of a treaty obligation, which is possible even if the same actions also violate the state’s contractual obligations to the investor. A treaty obligation maintains its character whether or not a state, or an instrumentality of the state, enters into a contract with an investor. The contract may increase the obligations of the state to the investor, but it cannot somehow strip a tribunal of its ability to analyze and decide whether state conduct violates a treaty.

1 Customary International Law and Investment Treaties Provide Substantive Protection to Investors for State Breaches of Contract

It is well established under international law that a state is liable when it expropriates a foreign investor’s contractual rights. The Permanent Court of International Justice, in the landmark Chorzów Factory case, concluded that Poland’s seizure of a factory and machinery in Chorzów also constituted an expropriation of the patents and contract rights of the company managing the factory. ICSID jurisprudence has followed similar reasoning. In SPP v. Egypt, an ICSID tribunal found that the claimant was entitled to compensation for the Egyptian Government’s expropriation of its contractual rights because “it has long been recognized that contractual rights may be indirectly expropriated.”

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2 As Brice Clagett put it, “[c]ustomary international law has long regarded such elementary principles as respect for lawfully acquired property rights and respect for lawfully concluded agreements (pacta sunt servanda) as the cornerstones of relations between States and alien investors. It is believed that State liability for breach of these obligations has never been seriously questioned by any twentieth-century arbitral tribunal or other international adjudicatory authority. To the contrary, international tribunals have repeatedly held, in decisions spanning the last hundred years, that under customary international law, when a State takes an alien investor’s property, the investor must be compensated.” Brice M. Clagett, Just Compensation in International Law: The Issues Before the Iran-United States Claims Tribunal, in The Valuation of Nationalized Property in International Law (Volume IV) 31, 38 (Richard B. Lillich ed., 1987).
