International Arbitration Alert

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‘Protecting’ International Construction Contracts—Investment Treaty or International Construction Arbitration?

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Economic uncertainty around raw materials and shifts in post-pandemic planning has created tangible tensions surrounding international construction and infrastructure “mega projects”. There is a new focus on investment protections and protections afforded by international arbitration. Reliance on Investment Treaty protections by international construction developers and contractors is illustrated by the filing of International Centre for Settlement of Investment Disputes (ICSID) Case No. ARB/21/48 in the *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v. Republic of Pakistan*. Bayindir, a leading Turkish construction contractor, has recently lodged a second Investment Treaty arbitration in respect of the same major transportation project following dismissal of its previous claims more than a decade ago on the basis that the disputes with the state were largely contractual in nature and that: “Investment treaties are not meant to protect against business risks”.[1]

Patently, stakeholders contemplating invoking an Investment Treaty in addition to (or instead of) international construction arbitration ought to note:

- Parties cannot ignore divisions between commercial / contractual issues in favour of a “wrapped up” Investment Treaty arbitration. Parallel (but stayed) proceedings may be inevitable.
- Investment Tribunals are inclined to exercise jurisdictional restraint in complex construction / infrastructure disputes.
- An overall dispute resolution strategy which blends contractual protections for payment and disputes with investment protections is key.

The number of Investment Treaty claims relating to construction and infrastructure projects is on the rise (see, e.g. 2020 ICSID Case Statistics).[2] Disputes arising out of such projects also appear set for increased growth. A number of interrelated issues are at play:

- Arbitral jurisdiction and remedies under Investment Treaties.
- Multi-tiered dispute resolution clauses.

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- The scope of so-called most favoured nation clauses “MFN” and Umbrella clauses under Investment Treaties.

Current Investment Treaty Tribunal jurisprudence underscores the fundamental point that Investment Treaties are a complement to—not a substitute for—sophisticated contract drafting.[3] Developers / contractors must pay attention to the contractual mechanisms for variations, extensions of time and changes to payments as well as the dispute resolution clauses included in their construction contracts and must exercise previously agreed contractual mechanisms in relation to common issues arising out of complex construction / infrastructure contracts. Expansive arbitral jurisdiction under Investment Treaties is not a “silver bullet” solution to uncertain contract drafting or poor contractual administration when a sovereign is a counter-party. To the contrary, Investment Tribunals are increasingly delineating the scope of their jurisdiction to only hearing claims arising under a breach of an Investment Treaty / International Law compared to claims for other common construction contractual remedies (such as claims for extensions of time, prolongation costs, cumulative impact, nonpayment and termination).

Complex Construction Contracts

The starting point for all construction / infrastructure disputes are construction contracts (very often based on an historic standard form such as Fédération Internationale Des Ingénieurs-Conseils (FIDIC)) which allocate risks across a number of parties (local authorities; developers; engineering, procurement and construction (EPC) contractors; subcontractors; etc.). For whatever reason, when tensions arise between the state and foreign contractors / developers, there is a tendency among some private entities and advisors to believe that the foreign contractor / developer enjoys “ultimate protection” from government “interference” under an Investment Treaty which also extends to common issues of contractual performance. This is sometimes colloquially referred to as an “investment treaty angle” to the contractual dispute. However, parties and advisors should be astute not to underestimate the importance of the underlying construction contracts even when such contracts require performance by state / local authorities.

There are principles in national legal systems that typically uphold drafting between sophisticated parties. Investment Tribunals acting under a Treaty / Public International Law, just like those working under national legal systems, are reluctant to set aside carefully crafted commercial bargains simply because a state actor is involved. It is therefore important to take the drafted commercial construction contract, rather than broad principles of international law as a starting point when it comes to many questions arising out of construction / infrastructure projects. Government “interference” cannot be implied simply because one party to the commercial contract is a sovereign or sovereign-related entity. It is a well established principle that state responsibility for breach of international law is conceptually distinct from responsibility for breach of contract, since “a State may breach a treaty without breaching a contract and vice versa”.[4]

As has been noted in many scholarly works over the past decades, examples of pure direct expropriations are fewer and farther in between. Much more common are cases alleging “creeping expropriation”; actions “tantamount to expropriation” or in violation of the Fair and Equitable Treatment standard—usually as an attempt to delineate financial consequences for a project that cannot be completed as originally envisaged.

Disputes occurring over the course of a complex construction / infrastructure contract (permitting, design, environmental approvals, import controls, extensions of time, variations, etc.) are not ripe or proper for Investment Treaty arbitration when there are bespoke contractual mechanisms for dealing with those issues.

Umbrella Clauses

The potential to bring claims arising out of a construction / infrastructure contract before a tribunal convened under an Investment Treaty needs discussion on so-called Umbrella Clauses. The scope and interpretation of such clauses are described as one of the thorniest issues in Investment Treaty disputes. An additional issue is the ability to import through Most Favoured Nations (MFN) Clauses umbrella clauses contained in other treaties signed by the host state. Leaving the MFN issue aside, Umbrella Clauses continue to be interpreted in varying ways commensurate to their terms and according to the arbitral tribunals.

For example, a recurring preliminary issue which is unsettled in Investment Treaty jurisprudence is whether as a "rule" of interpretation these clauses are to be construed narrowly, broadly or otherwise require an earlier decision from the contractually agreed mechanism before proceeding under the Investment Treaty. In the words of the Tribunal convened in *BIVAC BV v. Paraguay*: "there is no jurisprudence constante on the effect of umbrella clauses".[5] The approaches to interpreting Umbrella Clauses are summarized as follows:

> Three broad approaches have emerged in relation to umbrella clause claims. The first views such clauses restrictively, limiting their application to, perhaps, sovereign acts, and refusing to extend treaty protection to 'mere' contractual breaches. The second accepts in principle the invocation of an umbrella clause in cases of contractual breach, but considers that arbitral proceedings should be stayed pending a decision from the contractual forum (normally a domestic court or tribunal) adjudicating the allegations of contract breach. The third camp insists that umbrella clauses 'mean what they say,' elevating contractual breaches into treaty breaches and providing redress via the umbrella clause.[6]

Unsurprisingly, there are multiple approaches applied by Investment Tribunals which would preclude or stay Investment Treaty arbitration claims for breaches of common construction contract breaches.

Bilateral Investment Treaties are not a Substitute for Sophisticated Contracts

The recent Final Award in ICSID Case No. ARB/12/6 *Muhammet Çap & Bankrupt Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan* provides compelling guidance. The Tribunal analyzed the legal nature of the claims made (not simply the allegation that the claims arose out of breaches of the Investment Treaty) and found that a number of claims alleged by the claimant were not ripe for resolution under the Treaty. Rather, the claimant needed to pursue claims in the dispute resolution forum agreed in the contract (which included commercial arbitration and action before the local "arbitrage" courts).

The Tribunal exercised restrictively its jurisdiction over only a fraction of the claims (i.e. only where the state was acting in its sovereign capacity):

Disputes for Resolution under Construction Contract	**Disputes arising out of Sovereign Action**
Payment Delays and Payment Defaults	Visa Issuance
Variations / Change Orders	Restrictions on Procurement of Materials
Late Handover of Construction Sites	Interventions of Political Figures
Non-Compliance with Value-Added Tax (VAT) Obligations	Tax Audits / Seizures
Delay in Registration of Contract Annexes	Travel Bans, Arrests
Improper Visits to Construction Sites	
Non-Compliance with Final Handover Procedures	
Improper Liquidated Damages / Delay Penalties	
Unjustified Contract Terminations	

The Tribunal explicitly found that it did not have jurisdiction to adjudicate contractual claims:

> "claims which relate to contract performance issues, such as for non- or late payments, prolongation costs, extensions of time, are outside the Tribunal's jurisdiction and are not to be determined in this Arbitration."[7]

Muhammet Çap & Bankrupt Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan provides warnings for construction contractors. Contractors / developers cannot side-step their previously agreed contractual obligations, forums and remedies because they can access an Investment Treaty. The contract and project controls are critical for international contractors to remain protected and successfully realize the project—Investment Treaties are not a silver bullet.

[1] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. ("Bayindir") v. Republic of Pakistan*, ICSID Case No. ARB/03/29 (Final Award dated 27 August 2009) ¶ 482.

[2] ICSID Caseload – Statistics 2021-22 Edition, available at: https://icsid.worldbank.org/resources/publications/icsid-caseload-statistics (Showing a year-on-year increase in cases filed with the Centre in four out of the last six years with cases categorized as Oil, Gas & Mining; Electric Power & Other Energy; Construction and Transportation cases accounting for the majority of cases filed through 30 June 2021).

[3] See, e.g. *Muhammet Çap & Bankrupt Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, ICSID Case No. ARB/12/6 (Final Award dated 4 May 2021) ¶ 707 ("However, it is not enough to establish that there was an intervention from the State organs. For a treaty claim to exist, the action or omission attributable to the State must be characterized as a violation of an international obligation binding upon the State concerned.").

[4] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal (formerly Compagnie Générale des Eaux) v Argentine Republic*, ICSID Case No ARB/97/3, (Decision on Annulment dated 3 July 2002) ¶¶ 95-96; *Azurix Corp. v Argentine Republic*, ICSID Case No ARB/01/12, (Decision on Jurisdiction dated 8 December 2003) ¶ 76.

[5] *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC BV v. The Republic of Paraguay*, ICSID Case No. ARB/07/9 (Decision of the Tribunal on Objections to Jurisdiction dated 29 May 2009) ¶ 141.

[6] Borzu Sabahi, Noah Rubins, et al., Investor-State Arbitration ¶15.06 (2d ed. Oxford University Press 2019).

[7] *Muhammet Çap & Bankrupt Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, Final Award ¶ 709.

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