Introduction

Investment contracts, generally understood as written agreements between foreign investors and host States or host State entities setting out their respective obligations in relation to a given venture, are the principal means by which foreign investment enters the territory of a host State. Common species of investment contracts include natural resource concessions, public service concessions, build-operate-and-transfer contracts and public–private partnerships.[1] Given how commonplace investment contracts are in begetting foreign capital inflow, the great majority of disputes between foreign investors and host States are contractual in origin. An important issue in investor-State disputes involving investment contracts is whether the breach of an investment contract by a State engages its responsibility under international law. Notwithstanding widespread acceptance that a breach of contract by a State may amount to an internationally wrongful act, the law of State responsibility for breaches of investment contracts seems unsettled.

A key reason for the uncertainty is the perception that the engagement of State responsibility for contractual breaches is exceptional. In 1970, the International Law Commission expunged the topic of contractual breaches for good from its codification project on State responsibility.[2] According to Special Rapporteur Roberto Ago, '[t]he violation by a State of a contractual obligation does not constitute, in and of itself, the objective element of an internationally wrongful act and is not at all capable of giving rise to State responsibility; the violation is subject to a different legal

[1] For an overview of the different types of investment contracts, see J. Ho, 'Investment Contracts and Internationalisation' in C. L. Lim, J. Ho and M. Paparinskis, *International Investment Law and Arbitration – Commentary, Awards and Other Materials* (Cambridge: Cambridge University Press, 2018) pp. 37, 52–4.

[2] R. Ago, 'First Report on State Responsibility' (7 May 1969–20 January 1970), UN Doc. A/CN.4/217, p. 137.

order, be it national law or some other law'.[3] Since this pronouncement, no detailed study has been undertaken to articulate what the law of State responsibility on contractual breaches is.

Inertia masks advancement. Legal development is evident in the case of investment contracts because foreign investors habitually invoke international law to protect their contractual rights. Early investors sought protection for their contractual rights from general international law on the treatment of aliens and alien property. Latter-day investors seek protection for their contractual rights from an array of investment treaty provisions conferring substantive protection on qualifying investments. Recurrent attempts to engage a host State's international responsibility for breaching an investment contract offered ample opportunity for this sub-field of the law of State responsibility to flourish.

There is a wealth of material that shapes the law of State responsibility for breaches of investment contracts. First impressions of an unsettled or uncertain law have thus far gone unchallenged. But unchallenged first impressions point to the need for a detailed study that investigates and analyses the sources, the content, the characteristics and the evolution of this law. The frequency which State responsibility for breaches of investment contracts arises for consideration in investor-State disputes, calls for a coherent and long overdue answer to the question of what the law of State responsibility for breaches of investment contracts *is*. This is the lacuna in the existing legal literature that this monograph has been written to address.[4]

The argument at the heart of this monograph is that the law of State responsibility for breaches of investment contracts has carved a unique and distinct trajectory from the traditional route for the creation of

[3] R. Ago, 'Fifth Report on State Responsibility to the ILC' (22 March 1976), UN Doc. A/CN.4/291, pp. 12–13. Author's translation from the original French.

[4] While various international law issues arising from investment contracts have been discussed in a series of influential articles by F. A. Mann, C. F. Amerasinghe, P. Weil, G. R. Delaume, G. Sacerdoti and V. V. Veeder, these articles date from the 1940s to the 1990s. Little has been written about investment contracts in the last three decades which have witnessed momentous developments. See F. A. Mann, 'The Law Governing State Contracts' (1944) 21 BYIL 11; same author, 'State Contracts and State Responsibility' (1960) 54 AJIL 572; C. F. Amerasinghe, 'State Breaches of Contracts with Aliens and International Law' (1964) 58 AJIL 881; P. Weil, 'Problèmes Relatifs aux Contrats Passés entre un Etat et un Particulier' (1969) 128(3) *Recueil des Cours* 95; G. R. Delaume, 'State Contracts and Transnational Arbitration' (1981) 75 AJIL 784; G. Sacerdoti, 'State Contracts and International Law: A Reappraisal' (1986–7) 7 *Italian Yearbook of International Law* 26; and V. V. Veeder, 'The Lena Goldfields Arbitration: The Historical Roots of Three Ideas' (1998) 47 ICLQ 747.

international law. Unlike the rest of the law of State responsibility which developed from the diplomatic and treaty practice of States, the law of State responsibility for breaches of investment contracts developed principally from arbitral awards. And despite the absence of a system of binding precedent in international arbitration, the law of State responsibility for breaches of investment contracts has managed to defy the odds and develop in a fairly stable manner. It mimics, to a considerable extent, the general international law on the protection of aliens and alien property. Characterising the law, as Ago once did, as one of exceptional application, understates the possibility of State responsibility being engaged for a breach of contract, and underestimates the role it has played and will continue to play in investment contract protection. The argument rests on a three-part structure, corresponding to a past-present-future framework of analysis. This chronological framework showcases the three critical and connected phases in the development of the law of State responsibility for breaches of investment contracts.

Phase 1 traces the historical context from which the law was borne. History is crucial to the setting out of the *lex lata* for three reasons.

First, it shows that the law of State responsibility on contractual breaches developed from arbitral awards not by chance, but by circumstance. States were often requested by their nationals to present contract claims to foreign States. Yet, despite many opportunities to explore the possibility of invoking international law in diplomatic correspondence and gravitate towards a shared body of rules, the treatment of contract claims differed from State to State and was rarely grounded in law (Chapter 1). This encouraged the perception that States were generally disinclined to bring contractual breaches within the purview of international law.

Second, this perceived disinclination, which only comes to light with a historical survey, has important ramifications for how the law of State responsibility for breaches of investment contracts will develop. Over time, arbitral *jurisprudence* revealed that conditions for the engagement of State responsibility for contractual breaches were mostly drawn from the well-established conditions found in the general international law on the treatment of aliens and alien property (see *Phase 2* below). The exception was 'internationalisation', which advocated the engagement of State responsibility for all contractual breaches. However, 'internationalisation' encountered and continues to encounter strong resistance from the arbitration community (see *Phase 2* below). The oft-canvassed reason for this resistance is deficiencies in the various theories of 'internationalisation'. But the more profound reason, and one which only recourse to history

fleshes out, is because 'internationalisation' is too far removed from the perceived disinclination of States to frame contractual breaches as violations of international law, and from the baseline for investment contract protection found in general international law.

Third, the unusually prominent role arbitral awards play in articulating the law of State responsibility for breaches of investment contracts requires explanation. The absence of customary international law specific to contractual breaches, ambiguous treaty practice, and incomplete, aborted or shelved codification efforts gave rise to a unique set of circumstances which enabled arbitral awards to become a principal source of international law (Chapter 2). This phenomenon existed before the current age of investment treaty arbitration where arbitral awards are often taken for granted as the first port of call for research into international investment law. When viewed in its proper and illuminating historical context, there are good reasons why the law of State responsibility for breaches of investment contracts developed through arbitral awards. History thus provides a strong justification for why arbitral awards, despite being traditionally viewed as a subsidiary source of international law, can be instrumental in bringing about legal development and change.

Phase 2 investigates why the development of the law of State responsibility for breaches of investment contracts, despite being located in arbitral *jurisprudence*, has been more harmonious than haphazard. The most plausible explanation for this is the greater inclination of arbitral tribunals to adopt, adapt and apply established rules on the protection of aliens and alien property to contractual breaches. This is why arbitral *jurisprudence* on the core standard of treatment, which is derivative of the minimum standard of treatment of aliens and reflected in the treaty standard of Fair and Equitable Treatment (FET) of qualifying investments (Chapter 3), and the unlawful expropriation of contractual rights (Chapter 4), both under general international law and investment treaty law, possesses greater potential for coherent development. Anchoring a developing law to settled law is a promising recipe for legal certainty and stability. In contrast, radical theories espoused by a few arbitral tribunals to facilitate the engagement of State responsibility for investment contracts in the name of investment protection inevitably encounter resistance and rejection. The 'internationalisation' of investment contracts is a case in point because neither general international law nor umbrella clauses in investment treaties provides firm support for the conversion of contractual obligations into international obligations (Chapter 5). Irreconcilable rulings abound precisely because

arbitral tribunals are unfettered by earlier arbitral awards advocating dubious uses of international law.

Phase 3 anticipates how the relationships between general international law and investment treaty law will shape future content of the emerging international law on investment contract protection, which will in turn influence future strategy on bringing international investment contract claims. Conditions for the engagement of State responsibility for contractual breaches, while ascertainable to date, are neither cast in stone nor a closed list. It is therefore necessary to explore how the law may evolve, and how this evolution may affect the prospects of international investment contract claims. The findings in *Phase 2* predict that the future of investment contract protection lies in moderation. Legal development will entrench and elaborate on qualified contractual protection, numbering the days of absolute contractual protection through 'internationalisation'. The reliability of this prediction is strengthened in two ways.

First, through the stabilising influence of the general international law on investment treaty law on the topic of investment contract protection (Chapter 6). General international law supplies the foundational content for investment treaty law and is relevant to the interpretation of investment treaty provisions invoked for investment contract protection. Content articulation or content development for investment treaty law attracts far less controversy when it preserves the position in general international law, than when it deviates significantly, in the absence of unambiguous treaty language authorising the deviation, from that position. Therefore, with the probable demise of absolute contractual protection which finds little to no support in general international law, future development of the law of State responsibility will likely be led by contractual breaches that violate the core standard of treatment or that amount to unlawful expropriations.

Second, through empirical evidence that FET claims, although better suited than unlawful expropriation and umbrella clause claims to investment contract protection, do not enjoy a higher success rate than the other two treaty claims (Chapter 7). The content of FET is grounded to the core standard of treatment, tempering the prospect that State responsibility for breaches of investment contracts will be casually engaged through a rapidly evolving and expansive definition of FET. That said, contract-based FET claims are poised to become a prominent category of international investment contract claims, given their undiluted focus on the manner of the host State's contractual breach and the relative predictability of the content of FET that is specific to investment contract protection.

Together, *Phases 1*, *2* and *3* outlined here demonstrate why the law of State responsibility for breaches of investment contracts should no longer be deemed unsettled or uncertain. Its sources, content, characteristics and evolution are all capable of articulation and analysis in a detailed yet compact study. Contrary to earlier wisdom, there is an international law on investment contract protection. The following chapters unveil the remarkable journey of this law from its origins, to its formation, to its arrival at the cusp of maturity.

1

Power and Principle in the Origins of Contractual Protection

> Given the refusal of the ex-Sultan to honour his obligations and to repay what has been due for the last 10 years, not only for recent expenditures, but also for jewellery and money obtained on credit, I am forced to officially request the Dutch authorities at The Hague and in Riau to promptly reimburse Mr Sabatier, by whatever means they deem appropriate …
>
> We find ourselves, I admit, in the presence of a delicate question of international law, but it seems at first glance difficult to ask the protector nation of an indigenous Prince to assume his obligations and meet the debts that he contracted in his capacity as a sovereign.
>
> *Letter from the French Consul to the Dutch Consul General in Singapore, 28 March 1911*[1]

> [H]is Excellency the Governor General of the Dutch Indies, is of the opinion that the debt referred to in your letter cannot be considered as anything other than a debt of a purely private character, and for which the appeal by Mr Sabatier to the good offices of the [French] government does not appear justified.
>
> *Response from the Dutch Consul General to the French Consul in Singapore, 7 June 1911*[2]

1.1 Introduction

When investors in the past were embroiled in contractual disputes with foreign States, they never quite knew what to expect. Like Mr Sabatier, the claimant may first submit a contract claim to its home State, requesting diplomatic support. Like Mr Sabatier, the claimant then awaits the discretionary decision of its home State to offer diplomatic support. And like Mr Sabatier, the supported claimant may eventually receive no satisfaction when the host State firmly denies the home State's demand for payment,

[1] Archives Diplomatiques La Courneuve, 138CPCOM/6. Author's translation from the original French.
[2] Ibid.

regardless of the factual or legal merits of the claim. If we fixate on the outcome of *Réclamation Sabatier*, which is typical of contract claims presented through diplomatic channels, the excerpt above is no more than a reproduction of a short-lived diplomatic exchange. A closer reading of *Réclamation Sabatier* reveals that it is actually a microcosm of the circumstances that led to the emergence of legal content on contractual protection, and where both power and principle converged in the making of international law.

Power is commonly understood as anything that establishes and maintains control and domination of a person by another person.[3] In inter-State relations, power can be asserted through a multitude of ways, ranging from a written demand to armed intervention, to procure a desired outcome. The content of asserted power in a given scenario may be one dimensional, such as the isolated pursuit of the desired outcome, or multidimensional, such as the concurrent pursuit of discrete objectives. The assertion of power by a claimant State may not procure a desired outcome if the respondent State neutralises the attempt at control and domination. *Réclamation Sabatier* involved the assertion and counter-assertion of power that did not bring about the desired outcome for the claimant State, France. In its written demand, France asserted the power to determine the outcome of the dispute (the satisfaction of the contract claim by the Netherlands), the power to determine the format of dispute settlement (the recourse to diplomacy) and the power to determine the legal content on contractual protection (the characterisation of a contractual breach as a question of international law). In its response, the Netherlands counter-asserted the power to reject all the French stipulations, attempting to neutralise the French attempt at domination and control. France's decision not to press the claim, for reasons that have never been made known, enabled the Dutch counter-assertion of power to prevail.

[3] H. Morgenthau, *Politics among Nations: The Struggle for Power and Peace* (revised by K. W. Thompson and W. D. Clinton), 7th edn (New York, NY: McGraw-Hill, 2006), p. 11. Although Morgenthau's definition of power has been criticised (see for instance K. J. Holsti, 'The Concept of Power in the Study of International Relations' (1964) 7(4) *International Studies Quarterly* 179), it has withstood significant revision in seven editions of the leading treatise on international relations. In the first edition of *Politics among Nations* (New York, NY: A. A. Knopf, 1948), p. 13, power was defined as 'man's control over the minds and actions of other men'. Its ability to capture and adapt to evolving inter-State dynamics over nearly six decades, in contexts ranging from the aftermath of World War II, to the Cold War, and to the ongoing war against terror, attests to it applicability to a wide variety of settings, including the present one on contractual protection.

The three-pronged content of power in *Réclamation Sabatier*, namely, the power to determine the outcome of the dispute, the power to determine the format of dispute settlement, and the power to determine the legal content on contractual protection, is present to varying degrees in three sequential periods in history that housed different approaches of the principal trading nations of France, the Netherlands, the United Kingdom and the United States to contractual protection. The first period is the early 1800s to the early 1900s where contract claims were presented through diplomatic channels, and where the power to determine the outcome of the dispute was the dominant, and often solitary, theme in diplomatic missives. The second period is the early 1900s to the 1920s where home States asserted the power to determine the format of contract claim resolution. Instead of taking the usual diplomatic route, they persuaded a number of host States to have outstanding claims decided by standing bodies with State-appointed commissioners. These bodies, also known as Mixed Claims Commissions, are formally tasked by their founding States with the impartial adjudication of claims in accordance with principles of law. The power to determine the legal content on contractual protection and the outcome of the dispute was delegated to the Commissions.[4] The third period is the 1920s to the 1990s where States and private actors began asserting the power to determine the legal content on contractual protection through codification projects on international law. Some States and private actors further asserted the power to determine the outcome of future disputes, by inserting or attempting to insert a clause equating every breach of contract by a host State to an international wrong in model investment protection codes. Such a clause prohibits any interference with a concluded contract and advocates absolute contractual protection.

[4] The establishment of Mixed Claims Commissions is the extension of ancient practice, where States agree to settle their disputes peacefully by submitting these disputes to a tribunal comprising distinguished individuals, or to a court, whose decision is binding on the disputing States. The earliest recorded example of the pacific settlement of a dispute through third-party adjudication dates back to 750 BC. It involved the city-State of Lacedaemon (later known as Sparta) and the autonomous region of Messenia, both territories being part of modern-day Greece. The dispute, which arose from the murder of Lacedonians by a Messenian and the subsequent refusal of Messenia to commit its citizen to trial in Lacedaemon, was eventually submitted to a court in Athens for resolution. A fuller account of this dispute and its aftermath is found in Pausanias, *Description of Greece* (translated by W. H. S. Jones), revd edn (Cambridge, MA: Harvard University Press, 1918), Book IV, paras. 4.4.5–4.5.9. Other early examples of inter-State arbitrations are reviewed in W. L. Westermann, 'Interstate Arbitration in Antiquity' (1907) 2(5) *The Classical Journal* 197.

Legal content on contractual protection emerged in the second and third periods, where the power to determine such content was regularly asserted, be it by Mixed Claims Commissions exercising a delegated power, or by the launch of codification projects. Yet, the principles of law that were identified and applied by the Commissions to determine the outcome of contractual disputes grew authoritative over time, while the prospect of absolute contractual protection in certain model codes was and remains controversial. The different fates that different principles on contractual protection experienced suggest that States and other actors in international law have been more willing to affirm principles enunciated in certain circumstances than in others. It may therefore be said that although the power to determine legal content was asserted in both the awards of the Mixed Claims Commissions and in the model clauses presented by codifiers as restatements of international law, the principles on contractual protection that emerged in the former context exerted a stronger compliance pull than the principle of absolute contractual protection that was advocated in the latter.[5]

This chapter argues that while the frequent assertion of the power to determine the legal content on the international responsibility of States towards contractual protection enables the emergence of such content, it is the assertion of this power in circumstances that inhibit content crafting to the obvious benefit of one State or a select group of States, that elevates the compliance pull of articulated content.[6] These circumstances were present

[5] T. M. Franck, *The Power of Legitimacy among Nations* (Oxford: Oxford University Press, 2010), pp. 24–6. Franck identifies 'legitimacy' as the variable that determines the strength of a rule's compliance pull, and defines it as 'a property of a rule or rule-making institution which itself exerts a pull toward compliance on those addressed normatively because those addressed believe that the rule or institution has come into being an operates in accordance with generally accepted principles of right process'. This chapter does not challenge Franck's proposed nexus between a rule's legitimacy and its compliance pull. It eschews the label of 'legitimacy' with the open-endedness of circumstances surrounding the emergence of principles of contractual protection, because the latter already explains the difference in compliance pull across principles, without the additional assignment of degrees of 'legitimacy' to different principles.

[6] The use of power in this chapter to explain the legal origins of contractual protection is analogous to the use of power to explain the rise of arbitration as a mode of international commercial dispute settlement. In T. Hale, *Between Interests and Law: The Politics of Transnational Commercial Disputes* (Cambridge: Cambridge University Press, 2015), p. 10, Hale argues that arbitration was popularised through 'market power'. This is animated by a firm's 'demand' for a particular dispute resolution institution, whose success vis-à-vis firms with conflicting 'demands' is 'determined by the attendant constellation of power and interests, which [in turn] determines the "supply" of institutional outcomes'; see also pp. 58–61. In this chapter, the power to determine the mode of dispute settlement is asserted by States