Journal of Comparative Civil Procedure
Vol. 1, No. 2, Autumn & Winter 2026

Specialised & Scientific Bi-Quarterly
https://www.compcp.ir/

The Articulation of Contractual Claims in Commercial and Investment Arbitration

Majid Ghamami: Associate Professor of Civil & Commercial Procedure Private & Islamic Law Department. Faculty of Law & Political Science. University of Tehran. Director of Research Center of Justice & Civil Procedure. mghamami@ut.ac.ir

Abstract

This article investigates the articulation of contractual claims within the framework of commercial and investment arbitration, addressing the recurrent question of when a contractual breach by a state-owned entity may rise to the level of a treaty breach attributable to the host state. Through a doctrinal and jurisprudential analysis, it traces the evolution of this issue from early academic debate to key arbitral precedents such as SGS v. Pakistan, SGS v. Philippines, and Garanti Koza v. Turkmenistan. The article discusses the interpretive challenges surrounding umbrella clauses, the distinction between contractual and treaty obligations, and the impact of forum selection clauses on arbitral jurisdiction. It further assesses the role of broadly drafted dispute resolution and most-favoured-nation clauses in extending treaty protection to contractual breaches. The analysis demonstrates that arbitral practice remains inconsistent and fragmented, revealing tensions between party autonomy under contract and the internationalisation of state responsibility under investment treaties. Drawing on comparative case law and practical experience from Iran, the article concludes with drafting recommendations for foreign direct investment contracts

to preserve treaty-based avenues of redress. By clarifying the conditions under which contractual obligations may be internationalised, this study contributes to ongoing debates on jurisdictional boundaries and the convergence of commercial and investment arbitration.

Keywords: Arbitration, BITs, Contractual Breach, International Investment Law, Treaty Breach, Umbrella Clause.

1. Introductory

It is becoming a normal practice that the foreign investment projects are being implemented through contractual arrangements between the investors and governmental instrumentalities of the host states.

In most cases, the contractual arrangement between an investor and a host state subsidiary or controlled entity (investment contract) contains a forum selection clause for submission the disputes arising out of investment contract to either a domestic adjudicatory authority (be a court or an arbitral body) or, recently in a modernized trend, international commercial arbitration.

This being the premises, question may arise whether in the event that a state-owned entity party to an investment contract breaches its contractual obligations, could such breach eligibly be qualified as a breach of treaty by the contracting host state, which owns or otherwise controls that entity. There are albeit some factual requirements which are necessary to be satisfied for such a question being relevant. The most important requirement is that the series of facts, constituting the breach of investment contract, are qualified in one or another way at the same time to shape a valid cause of action for bringing a claim under treaty. There is still another underlying requirement, by which the treaty in question must allow for such a construction of cause of claim.

Considering precedent, there are two potential hypotheses in which the treaty may, arguably, allow the investor to decide seriously to try its chance with treaty arbitration. First situation is when the treaty contains an umbrella clause, also known as observance of undertakings, and second, when the dispute resolution clause of treaty is drafted with a comprehensive and inclusive attitude to cover all and any disputes arising out of investment under the treaty. The aim of this article is to discuss the questions arise from these hypotheses.

2. Historical Background

The debate was first introduced at the doctrinal level in 1960s by authorities such as Professor Weil and Sir Elihu Lautherpacht in the Collected Courses of The Hague Academy of International Law. The theoretical framework of dis-

cussion was the problems related to the contracts entered into by the states and private individuals.

It was only in 2003 that the question put to the test in arbitral case law before the Arbitral Tribunal constituted in *SGS v. Pakistan*. *SGS* was a Swiss company who entered into a pre-shipment inspection agreement (PSI) with Pakistan. The PSI was mutually performed, although the parties disputed the adequacy of each other's performance. The disputes between the parties as regards the validity and consequences of termination of the PSI gave rise to different proceedings. In parallel of claims brought by Pakistan before the contractually agreed forum, *SGS* sought the resolution of its disputes with Pakistan under the BIT between Pakistan and Swiss Confederation (2001) and initiated an ICSID arbitration arguing that Pakistan violated its treaty obligations including *inter alia*, that of constantly guarantee the observance of the commitments Pakistan had entered into, namely its contractual commitments.

The ICSID Tribunal determined that the disputes between the parties originated in a contractual relationship, whereas the relationship was later governed by BIT.

The Tribunal, however, declined jurisdiction with respect to claims based on alleged breaches of PSI contract. The decision of the Tribunal, in the above-mentioned case, was subject to much criticism and the question of distinction based on the different causes of action resulting from the same fact or series of facts continued to be a problematic of international investment arbitration.

This article, also, elaborates on the key issues of this argument with proper reference to the related cases through the following sections.

3. Analytical Discussion

3-1. Jurisdiction of an International Tribunal over purely Contractual Breaches

When a treaty contains an umbrella clause or broadly defines the investment agreements in the dispute resolution article, It is crucial that the wording of the umbrella clause be carefully taken to consideration. If the wording of the umbrella clause is sufficiently broad, as was the case in SGS Société Générale de Surveillance S.A. v. The Republic of Paraguay, ICSID Case No. ARB/07/29, a dispute relating to the non-payment of invoices for services rendered, an international tribunal would accept jurisdiction over a dispute originating in a breach of contract despite the precedent cited herein above regarding the ICSID case of SGS v. Pakistan. However, the tribunal will only verify whether there was a breach of contract in order to then examine whether there was a breach of the treaty, since this is the source of the claim (*SGS v. Philippines*, 2003, para. 142). This is done without prejudice to the jurisdiction of another forum finding a party liable for breach of contract.

If a breach of contract has nothing to do with an investment (e.g., *"A failure by a government agency to pay for a box of pencils delivered pursuant to an agreement to provide office supplies"*), the tribunal will not uphold jurisdiction (*Garanti Koza LLP v. Turkmenistan*, 2016, para. 330).

Notwithstanding the above, legal opinion is divided on this issue. In sum, the implications of the presence of an umbrella clause in a treaty is debated. Four main doctrines can be distinguished:

1. Umbrella clauses merely require States to enact a legal framework enabling the investors to enforce commitments entered into by the host State (*SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, 2003, para. 172). Umbrella clauses cover only breaches of contracts or undertakings committed in the exercise of sovereign authority/power (*Supervision y Control S.A. v. Republic of Costa Rica*, 2017, para. 282). Umbrella clauses internationalise contracts and unilateral undertakings of the host State (*Noble Ventures, Inc. v. Romania*, 2005, para. 53). Umbrella clauses are an enforcement mechanism but do not internationalise contracts (*Toto Costruzioni Generali S.p.A. v. Republic of Lebanon*, 2009, para. 202).

آیین دادرسی مدنی تطبیقی
Comparative Civil Procedure
Vol. 1, No. 2,
Autumn & Winter
2026

3-2. Identifying the Correct Cause of Action by a Tribunal

Investment tribunals are only concerned with applying the clauses of the BIT. This is the approach that is highlighted in the tribunal in tribunal in Georg Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia, ICSID Case No. ARB/12/39, a case which concerned, inter alia, the breach of a purchase agreement relating to several companies, held that:

"If, in order to assess whether there was a treaty breach, the Tribunal must first determine whether or not the relevant contractual obligations have been observed, then the Tribunal may hear evidence and make that determination. That some of the facts underlying the umbrella clause claim could also be the basis for a separate breach of contract claim—in another forum, on another day—is immaterial. The Claimants' umbrella clause claim requires a determination of whether the Respondent breached the BIT. Because that inquiry, in turn, requires a determination of whether or not the Respondent observed its contractual obligations, the Tribunal should and will proceed to make that determination" (Georg Gavrilovic & Gavrilovic d.o.o. v. Republic of Croatia, 2018, para. 421). In other words, investment tribunal have to reach to this satisfactory result that the breach of the underlying investment contract has necessary characteristics to constitute a treaty breach regardless of another concurrent dispute resolution arrangement is available for the parties for the same set of facts. It could not be presumed based on a fiction and it does not have any impact on the jurisdiction of tribunal according to the overarching precedent of ICSID.

3-3.The Impact of Contractual Dispute-Resolution Clauses on a Tribunal's Jurisdiction in Investment Arbitration.

The impact of a forum selection clause in a contract is debated. Some tribunals, when faced with a forum selection clause in a contract, have declined jurisdiction (*Kontinental Conseil Ingénierie v. Gabonese Republic*, 2016, para. 179): free translation – "*On the other hand, the investor cannot invoke the jurisdiction of the treaty tribunal: […] (b) when the investor has accepted a jurisdiction clause, which precludes any other jurisdiction based on general provisions (such as the provisions of a treaty), especially if these provisions predate the conclusion of the jurisdiction clause"*).

Other tribunals in the same situation have disregarded the forum selection clause in the contract and upheld jurisdiction to hear the dispute on the merits (*Belenergia S.A. v. Italian Republic*, 2019, para. 359).

In a third line of cases, tribunals have stayed proceedings pending the decision of the contractually agreed forum (*BIVAC B.V. v. Republic of Paraguay*, 2009, para. 290). It is worthy to add that the forum selection clause in an investment contract, as a pure procedural question, is disregarded in the course of assessment by tribunal of the facts (be the breach of investment contract or not) claimed to constitute a treaty breach.

3-4. Broad clause of dispute resolution mechanism in treaties and the Elevation of Contractual Breaches

The question of a BIT tribunal's jurisdiction over contractual claims, on the sole basis of a broadly drafted treaty dispute resolution clause, remains unsettled in ICSID case law. A first approach adopted in *saline v. Morocco, vivendi v. Argentina*, and subsequently in *SGS v. Philippines* consists of giving effect to the broad language of the dispute resolution clause. Under a second approach, espoused by the Tribunal in *SGS v, Pakistan*, the broad wording of the jurisdiction resolution clause found in the BIT is not sufficient justification for the jurisdiction of the treaty tribunal over purely contractual claims.

3-5. The Role of the MFN Clause in Expanding Jurisdiction over Contractual Claims

Commentators have written that the tribunals that rendered earlier awards enabling claimants to use an MFN clause to import an umbrella clause (notably *Mr. Franck Charles Arif v. Moldova and EDF v. Argentina*) failed to rigorously interpret the relevant provisions in the basic treaty in question and to ensure compliance with the *ejusdem generis* principle (Gazzini & Tanzi, 2013, pp. 982–983, 990–991, 993). Given that the wording of MFN and umbrella clauses can vary from treaty to treaty, a rigorous interpretation in accordance with the Vienna Convention on the Law of Treaties (VCLT) is necessary.

A number of more recent awards, which contain such an in-depth analysis, ultimately concluded that the MFN clauses in question cannot not be used to import an umbrella clause in another treaty *(İçkale İnşaat Ltd. Şti. v. Turkmenistan, 2016, paras. 326–332; WNC Factoring Ltd. v. Czech Republic, 2017, paras. 348–358; Teinver S.A. et al. v. Argentina, 2017, paras. 884–892)*.

Finally, the tribunal in Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia, UNCITRAL denied the use of an MFN clause to import an umbrella clause *(Sergei Paushok et al. v. Government of Mongolia, para. 570)*.

3-6. Seeking Contractual Remedies through Treaty Arbitration: Examine the Case of BOT Power Purchase Agreements

As referred to herein above (3-2), investment tribunals are only concerned with applying the clauses of the BIT.

Now, a question may arise in relation to whether a tribunal has jurisdiction over pure contract claims. In principle, an investment arbitral tribunal has no jurisdiction over a purely contractual claim since "*a breach of contract does not per se trigger a breach of treaty protection*."

In other words, an investment tribunal has jurisdiction only in the case where claimant's claims arise out of a BIT. In this sense a tribunal concluded in a recent award that a contract breach is unlikely to be sufficient to retain a breach of the treaty, "and the State would have to have acted in its sovereign capacity" for a claim to arise under the respective BIT (Cambodia Power Company v. Kingdom of Cambodia, ICSID Case No. ARB/09/1). In another case, the tribunal decided that it had no jurisdiction given that claimant's claim was a simple contractual claim "dressed up as a Treaty case" that had already been decided in a previous arbitration between the same parties by a tribunal whose jurisdiction, contrary to the second tribunal, encompassed treaty claims, but also contractual claims (Michael Waibel, 2014).

To determine whether the claimant is bringing contract or treaty claims, the ad hoc committee in Vivendi I ruled that the tribunal must consider the fundamental basis of the claimant's claim. Following the Vivendi I decision, several trends dealing with the distinction between treaty and contract claims have emerged. Practitioners and tribunals have suggested a distinction between treaty and contract claims based on five criteria which are not cumulative. Different tribunals have taken distinct approaches, but at least some of these criteria are present in most decisions:

i. Cause of the Claim: while the cause of a treaty claim is based on a violation of the bilateral or multilateral investment treaty, the cause of a contract claim stems from a violation of a contract provision;

ii. Content of the Right: usually treaty rights are contained and defined in BITs and international law. Contractual rights are defined by the contractual terms as well as the domestic laws of the host State;
iii. Parties to the Claim: whereas in investor-State disputes the parties involved are usually any qualifying investor and the host-State, the parties to contractual disputes are only the parties that signed the agreement.19 This might or might not include the host State;
iv. Applicable Law: treaty claims are governed by the provisions of the treaty, general principles of international law, and customary international law. Contractual claims are usually governed by the host-State's domestic laws;
v. Host State's Responsibility: a treaty breach will trigger the host State's international liability, whereas a contract breach will trigger the host State's contractual responsibility. (Michael Waibel, 2014)

It will be useful to examine the above with regards to the famed early transfer clauses in the power plant BOT contracts where the state-owned off taker of the electricity agrees to take over the power station prior to the expiry of the contract in case of breach and pays an agreed compensation. The question is whether this compensation would be enforceable in a treaty arbitration. In other words, does the contractual breach with a pre-determined remedy constitute a treaty breach.

Keeping the above arguments as a generally accepted approach in mind, it is valuable to remind that some commentators suggested that any contractual right including an agreed remedy under the contract would fall within the scope of definition of 'property' and consequently that of 'investment' and then deserved to be protected against treaty breaches (Demirkol, 2015, p. 413, also see AS Windoor v. Republic of Kazakhstan, ICSID Case No. ARB/18/32).

Conclusion

This article has examined the legal conditions under which breaches of investment contracts may be articulated as breaches of international investment treaties. The analysis shows that arbitral practice remains fragmented and that no settled approach has emerged regarding the elevation of contractual obligations to the treaty level. While tribunals consistently reaffirm the distinction between contractual and treaty causes of action, they diverge in assessing when the same factual conduct may engage both regimes.

The study confirms that umbrella clauses can, in principle, provide a legal basis for the internationalisation of contractual commitments, but their effect is highly dependent on treaty wording and interpretative methodology. Broad-

ly drafted dispute-resolution clauses, standing alone, are insufficient to confer jurisdiction over purely contractual claims in the absence of an independently identifiable treaty breach. The article further demonstrates that contractual forum-selection clauses do not automatically preclude treaty jurisdiction, although tribunals have attributed varying weight to such provisions. Finally, recent jurisprudence reflects a more restrictive approach to the use of most-favoured-nation clauses to import umbrella clauses from third treaties. Overall, investment tribunals may engage with contractual obligations only insofar as necessary to determine an alleged treaty breach, underscoring the persistent tension between contractual autonomy and the internationalisation of State responsibility.

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