

INTERFACE BETWEEN PUBLIC PROCUREMENT AND LAW ON PROTECTION OF FOREIGN INVESTMENTS

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ABSTRACT. The paper focuses on the attribution of acts of a state enterprise or state-owned company to the state and related state's responsibility towards foreign investors. This underdeveloped area of law deserves a closer examination because both public procurement and foreign investments can have a significant influence on state budgets and economies. The question of state's responsibility in relation to public procurement is of fundamental importance because even if from a short term perspective it can be advantageous for a state to waive its responsibility and thus avoid compensation towards foreign investors, in a long term perspective the investors should try to avoid investing in states where their investments are not properly protected. Therefore insecurity about the level of protection provided by various tribunals may cause harm to both, states and investors.

INTRODUCTION

The main consequences of unlawful or non-transparent tendering procedures are commonly known to everyone familiar with the topic. Penalty for the contracting authority, cancelation of the tender, in more serious cases possibility of criminal law proceedings. All on national level, where the contracting authority is supervised by the State it belongs to. But not everyone keeps in mind that in some cases the consequences might go far beyond the national borders and not the contracting authority but the State itself can face serious consequences. This will be the case if foreign investments are

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harmful by illegal tendering procedures and the investors defend rights they possess under bilateral investment treaties.

This paper seeks to study arbitral awards on foreign investment disputes related to public procurement and their consequences. The paper will compare two cases where the arbitral tribunals took completely different approach to a very similar cases. In 2001 in the decision *Salini v. Morocco*¹ (hereinafter the “*Salini case*”) the arbitral tribunal ruled that the state which owns 89% of shares of a company that has its own legal personality is liable for acts of such a company towards foreign investors. On the other hand in the case of *InterTrade v. Czech Republic*² (hereinafter the “*InterTrade case*”) another arbitral tribunal refused to hold the state responsible for tendering procedures held by a state enterprise stating that the enterprise that has its own legal personality and therefore the state cannot be responsible.

The aim of this paper is to discuss outcomes of the two above-mentioned arbitral awards from the public procurement perspective. The analysis will not contain conclusion whether the tendering procedures in question were in fact illegal or not because not enough factual information is available. Instead it will focus exclusively on the question when or under which conditions acts or omissions of a state enterprise or any other state owned or run company, while conducting tender proceedings, are attributable to a state so the state should be held responsible for loss caused to a foreign investor.

Attribution is one of the core elements of international investment law. If acts harming the investor cannot be attributable to the state, then the state has no duty to remedy the investor and the investor cannot claim any compensation under the bilateral investment treaty.

And what is the relationship between law on protection of foreign investments and public procurements? The core is the role of a state. Under bilateral investment treaties the state is obliged to protect foreign investments. The public procurement rules keep an eye on state, its organs and related bodies while spending money from public funds. The assumption which this paper seeks to prove is that

¹ *Salini Costruttori S.P.A. and Italstrade S.P.A. (Claimants) v. Kingdom of Morocco (Respondent)* ICSID Case No. ARB/00/4

² *InterTrade Holding GmbH (Germany, Claimant) and the Czech Republic (Respondent)*, PCA Case No. 2009-12

once state's money are spent through tender procedures the respective body conducting the procedure should observe duties arising out of bilateral treaties to protect foreign investors otherwise the state may be held responsible.

This paper will start with a short overview of the two above mentioned arbitral awards. Then it will move to the core of the paper which will provide analysis of the cases and discussion of the main points of state responsibility from a public procurement point of view. Subsequently short conclusion will follow.

ARBITRAL AWARDS OVERVIEW

The Salini Case

The claimants in this case are Italian companies Salini Costruttori S.p.A. and Italstrade S.p.A. (hereinafter "**Salini**"), the respondent is the Kingdom of Morocco. The subject matter of the arbitration is a dispute related to protection of a foreign investment related to contract concluded as a result of tendering procedure for construction of a highway. One of the first issues the tribunal had to solve was whether the respondent can be held responsible for acts conducted by the Société Nationale des Autoroutes du Maroc (hereinafter "**ADM**")³, a limited liability company that according to the Concession Agreement with the Moroccan ministry is responsible for maintenance of Moroccan highways.⁴

Salini claimed that the ADM breached contract concluded as a result of a tendering procedure and hereby caused Salini a financial loss. Therefore Morocco should be held responsible for Salini's loss of investment under the Treaty between the Government of the Kingdom of Morocco and the Government of the Republic of Italy for Reciprocal Promotion and Protection of Investments ("**Morocco-Italy BIT**").

To answer the possible responsibility of Morocco the Tribunal examined the legal position of ADM and its relationship to the kingdom that is an indirect owner of 89% of share capital of ADM. The tribunal assessed the relationship by criteria of structural and

³ Lesy ČR – Forests of the Czech Republic

⁴ Salini v. Morocco, arbitral award, *op. cit.*, para 2

functional tests previously used in *Maffezini v. Spain*⁵ and came to a decision⁶ that Morocco is responsible for acts of ADM. Unlike the tribunal in the *InterTrade* case here the tribunal did not use the ILC Articles on State Responsibility⁷ (hereinafter the “**ILC Articles on State Responsibility**”) because these were adopted just about the time when the tribunal made its decision.⁸

The *InterTrade* Case

The claimant, *InterTrade Holding GmbH* (“**InterTrade**”), is a German-based commercial company, the respondent is the Czech Republic. The subject matter of the arbitration is a dispute related to protection of a foreign investment respectively a claimed loss caused to foreign investor by allegedly unfair treatment during tender proceedings that violated the 2004 Act on Public procurement⁹ and the EU Legislation on public procurements¹⁰. But the core issue of the proceedings is a question whether the respondent can be held responsible for unfair tendering procedures conducted by *Lesy ČR* (“**LČR**”)¹¹, a state enterprise established by the Ministry of Agriculture to manage and administer state-owned forests.¹²

To clarify the position of a state enterprise under the Czech law, it can be founded only with a prior approval of the government and exclusively by a ministry which acts on behalf of the state.¹³ State enterprise conducts business activities under its own name but with the property of the state.¹⁴ The director of a state enterprise is appointed and dismissed by the respective minister or directly by the government¹⁵ and two thirds of members of the supervisory board are elected by the ministry which founded the enterprise.¹⁶

⁵ Emilio Agustín Maffezini and the Kingdom of Spain (ICSID Case No. ARB/97/7)

⁶ *Salini v. Morocco*, arbitral award, *op. cit.*, para 35

⁷ *InterTrade v. Czech*, arbitral award, *op. cit.*, paras 168 and 203-204

⁸ The ILC Articles on State Responsibility were adopted during The ILC’s fifty-third session that took place from 23 April to 1 June and 2 July to 10 August 2001, the tribunal held hearing about its jurisdiction on 3 May 2001

⁹ *InterTrade v. Czech*, arbitral award, *op. cit.*, para 57

¹⁰ *InterTrade v. Czech*, arbitral award, *op. cit.*, para 71

¹¹ *Lesy ČR – Forests of the Czech Republic*

¹² *InterTrade v. Czech*, arbitral award, *op. cit.*, para 41

¹³ Act on State Enterprise, *op. cit.*, article 3 section 1

¹⁴ Act on State Enterprise, *op. cit.*, article 2 section 1

¹⁵ Act on State Enterprise, *op. cit.*, article 12 section 2

¹⁶ Act on State Enterprise, *op. cit.*, article 13 section 2

Unlike in the Salini case, here the tribunal applied the ILC Articles on State Responsibility.¹⁷ The majority conclusion was that the Czech Republic cannot be held responsible for tendering process conducted by the state enterprise¹⁸ even if it was established by a state and the state has the power to appoint and dismiss the Director and 2/3 of the Supervisory Board.¹⁹ Even though both, the Salini case and the InterTrade case, have similar main features, the arbitral awards have completely different outcomes and therefore bring insecurity about possible result of similar disputes.

Separate Opinion of Henri Alvarez In The InterTrade Case

Contrary to the majority reasoning in the InterTrade case, one of the arbitrators had a different approach to the state responsibility and issued a separate opinion.²⁰ It expresses disagreement of the dissenting arbitrator on State's non-liability under the articles 4 and 5 of the ILC Articles of State Responsibility.

Even if the final outcome of the separate opinion would be the same for lack of causation,²¹ the discussion on state responsibility is different and attributes acts or omissions of LČR as a state enterprise to the state. In the separate opinion the arbitrator expressed the opinion that the respective Ministry (and therefore the state) had an interest in the tendering procedure and its outcomes and therefore was obliged to oversee the process to secure its correctness.²² He also added that the state must be held responsible because Ministry of agriculture as a state organ cannot waive its responsibility over the state forests simply by delegating its duties to another legal entity, moreover established and managed by the Ministry itself.²³

The dissenting arbitrator also came to the conclusion the tender did not involve only commercial activities but also sought to "*protect, preserve and ameliorate the forests.*"²⁴ This activity is conducted for

¹⁷ InterTrade v. Czech, arbitral award, *op. cit.*, paras 168 and 203-204

¹⁸ InterTrade v. Czech, arbitral award, *op. cit.*, paras 203-204

¹⁹ Act No. 77/1997 Coll. on State Enterprise ("Act on State Enterprise"), article 12

²⁰ InterTrade Holding GmbH (Germany, Claimant) and the Czech Republic (Respondent), Separate opinion of Henri Alvarez ("InterTrade v. Czech, separate opinion")

²¹ InterTrade v. Czech, separate opinion, *op. cit.*, para 2

²² InterTrade v. Czech, separate opinion, *op. cit.*, para 9

²³ InterTrade v. Czech, separate opinion, *op. cit.*, para 10

²⁴ InterTrade v. Czech, separate opinion, *op. cit.*, para 15

the benefit of public. As the tender was conducted in public interest the conclusion of the separate opinion is that LČR exercised governmental authority and therefore the state can be held liable if breach of the Czech-German BIT is proved.²⁵

State Responsibility for Acts of State Enterprises/State Owned Companies

The ILC Articles on State Responsibility were adopted by the International Law Commission of the United Nations in 2001 during its 53rd session.²⁶ Their aim is to formulate and codify “*the basic rules of international law concerning the responsibility of States for their internationally wrongful acts.*”²⁷ The ILC Articles on State Responsibility are of essential importance in order to establish whose acts during tendering procedures can be attributable to state. The Commentary on the ILC Articles on State Responsibility states that

*“State commissions or corporation may have separate legal personality under internal law, with separate accounts and separate liabilities. But international law does not permit a State to escape its international responsibilities by a mere process of internal subdivision.”*²⁸

This view is shared by most arbitrators in international investment disputes because “*generally, the practice of tribunals is consistent with the position that delegating the state’s activities to separate entities will not permit avoidance of responsibility for breach of treaty.*”²⁹ But this is exactly what the tribunal in the InterTrade case allowed. The Ministry (state organ whose acts are always attributable to the state) founded a state enterprise which then exercises some

²⁵ InterTrade v. Czech, separate opinion, *op. cit.*, paras 12 - 15

²⁶ United Nations (2010) Articles on Responsibility of States for Internationally Wrongful Acts - Procedural history. Available from <http://legal.un.org/avl/ha/rsiwa/rsiwa.html> (accessed on 6 December 2015)

²⁷ United Nations (2008) Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries. General commentary, art. 1, p. 31 Available online at: http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (accessed on 10 December 2015)

²⁸ United Nations (2008) Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries. p. 39 Available online at: http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (accessed on 10 December 2015)

²⁹ Dolzer, R., Schreuer, Ch. (2012) Principles of International Investment Law. Oxford: Oxford University Press, p. 490

duties legally belonging to the Ministry. And acts of this entity were not, according to the tribunal, attributable to the state. The next section of this paper will examine the two relevant articles of the ILC Articles on State Responsibility in relation to the Salini case and the InterTrade case.

State Responsibility under Art. 4 of ILC Articles on State Responsibility

Article 4(1) of ILC Articles on State Responsibility states that

conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.

Article 4(2) adds that *“an organ includes any person or entity which has that status in accordance with the internal law of the State.”*

In the InterTrade case the parties of the dispute agreed that LČR is not an organ of the State but the Ministry that founded LČR is.³⁰ The tribunal then refused to hold the Ministry responsible for acts of a state enterprise which the Ministry founded because it took the view that LČR has its own legal personality and acts on its own behalf.³¹ The very same reasoning was used by the kingdom in the Salini case, stating that ADM has is a private legal entity and therefore does not act on behalf of the kingdom.³² But unlike in the InterTrade case the tribunal in the Salini case refused to support this argument and ruled that the ADM was acting on behalf of the kingdom.³³

Opinion similar to the reasoning in the Salini case was expressed in the separate opinion in the InterTrade case. The dissenting arbitrator stated that *“it is clear from the evidence that the Ministry was integrally involved in the decision to conduct a tender for the express purpose of changing the way the forests were managed.”*³⁴ Then he goes on to conclude *“that the Ministry is a state organ that has a duty to manage the forests and despite the fact it delegated*

³⁰ InterTrade v. Czech, arbitral award, *op. cit.*, para 174

³¹ InterTrade v. Czech, arbitral award, *op. cit.*, para 177

³² Salini v. Morocco, *op. cit.*, para 29

³³ Salini v. Morocco, *op. cit.*, para 35

³⁴ InterTrade v. Czech, separate opinion, *op. cit.*, para 9

*some duties to LČR.*³⁵ Unlike the tribunal, the dissenting arbitrator is of opinion that acts of LČR can be attributed to the Czech Republic.

Moreover had not the Ministry in the InterTrade case established LČR it would have conducted the tendering procedures itself. This scenario is the same as in the Salini case. But the ruling of the arbitral tribunals substantially differ. Viewing the InterTrade case through the public procurement lenses it would be easier to agree with the dissenting arbitrator. His reasoning is very similar to that provided by the tribunal in the Salini case. The fact organ of a state established entity that later perform acts the state organ was originally obliged to do should keep the particular state organ responsible for behaviour of the entity.

State Responsibility under Art. 5 of the ILC Articles on State Responsibility

The Article 5 of the ILC Articles on State Responsibility contains the following rule

The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.

This rule applies in situation where the person or entity in question is not an organ of the state but exercises elements of governmental power and acts in that capacity.

In the InterTrade case the tribunal took into account reasoning of the arbitral tribunal in *Jan de Nul v Egypt*³⁶ arbitration award and accepted the view that the subject matter of the tendering procedure was irrelevant and “*the tribunal must look to the actual acts complained of.*”³⁷ The tribunal concluded that while conducting the tendering procedures the LČR acted in the way any other private owner of the forest would behave. So LČR was not exercising elements of governmental authority while choosing its contractual

³⁵ InterTrade v. Czech, separate opinion, *op. cit.*, para 11

³⁶ Jan de Nul N.V., Dredging International N.V. (Claimants) v. Arab Republic of Egypt (Respondent) ICSID Case No. ARB/04/13

³⁷ InterTrade v. Czech, arbitral award, *op. cit.*, para 184, quote of *Jan de Nul*

partners and therefore its acts cannot be attributed to the state. The tribunal concluded that InterTrade did not indicate any particular acts of LČR which involve governmental power so the state cannot be held responsible.

Rather than using Jan de Nul the tribunal in the InterTrade case should have looked for inspiration into the Salini case. Here the arbitral tribunal provided analysis of international liability of state for a commercial company.³⁸ The tribunal used the structural and functional criteria as described in *Maffezini v. Spain*.³⁹ In the structural analysis the tribunal considered the fact that the kingdom holds 89% of capital of ADM and has power over the Board of Directors as a sufficient basis to establish state's responsibility.⁴⁰ Compared to this, LČR is a state enterprise, the state is the founder and sole owner of the capital and has control to appoint a director and major part of Supervisory Board. From the point of view of the tribunal in Salini case and the structural test, the Czech Republic would have responsibility for LČR.

Second test described in *Maffezini* and used by the tribunal in the Salini case is the functional test. Here the tribunal should look to the function and role of the entity in question. In Salini case ADM was responsible for highways and other roads, in words of the tribunal for "*building, managing and operating of assets falling under the province of the public utilities responding to the structural needs of the Kingdom of Morocco with regard to infrastructure and efficient communication networks*,"⁴¹ This was for the tribunal enough to establish a state responsibility for an entity which fulfils tasks under state control. But maintenance of road and maintenance of forest is in fact very similar. Both roads and forests can be, in some cases, owned by private individuals and both serve a public purpose. Observing the functional test in the Salini case, the tribunal in the InterTrade should have held the state responsible for acts of LČR.

In the Salini case the arbitral tribunal observed that modern states more and more often act through various types of organizations, often similar to ADM.⁴² It complies with the

³⁸ Salini v. Morocco, *op. cit.*, para 31

³⁹ Emilio Agustín Maffezini and the Kingdom of Spain (ICSID Case No. ARB/97/7)

⁴⁰ Salini v. Morocco, *op. cit.*, para 32

⁴¹ Salini v. Morocco, *op. cit.*, para 33

⁴² Salini v. Morocco, *op. cit.*, para 35

observations of the Commentary on the ILC Articles on State Responsibility that states in relation to Article 5 that it *“is intended to take account of the increasingly common phenomenon of parastatal entities, which exercise elements of governmental authority in place of State organs.”*⁴³ This is the scenario in the InterTrade case where the Ministry was originally entitled to exercise certain powers and it delegated them to an entity the Ministry had established. This entity has the right to dispose with the state property in the same way the Ministry should have disposed had the entity not been established. And in the very same way the Moroccan Ministry would have acted not having ADM. Yet not all arbitrators share this view.

Last public procurement related remark related to the InterTrade case is that while conducting a tendering procedure, the contracting authority is spending public money and disposing with state property. Therefore the question in relation to article 5 of the ILC Articles on State Responsibility is simple. Isn't the mere fact the entity is spending state's money sign of exercise of governmental powers? There are no doubts that collecting public money, like taxes, duties and fees, is an exercise of governmental power. Reallocation of money in the state budget is also exercise of the governmental power. So why spending money from a state budget through a tendering procedure is not an exercise of governmental powers?

The whole purpose of the procurement regulation is to supervise how public funds are spent. Therefore only entities described in the public procurement legislation are bound by the rules. For this reason and from a public procurement point of view state should be responsible for a way in which public procurement contracts are awarded.

CONCLUSION

The aim of this paper was to analyse state responsibility to foreign investors for acts committed in relation to tendering procedures by a state enterprise or state owned/run company. The analysis was based on two arbitral awards, namely the disputes

⁴³ United Nations (2008) Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries. p. 42 Available online at: http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (accessed on 10 December 2015)

between the Italian companies Salini and Italstrade and the Kingdom of Morocco and a dispute German company InterTrade and the Czech Republic. The scope of analysis was limited to the responsibility of a state for acts of state enterprise or state owned company. Despite the fact that in one case the state enterprise administers state-owned forest and exercises powers the respective Ministry originally held and delegated to the state enterprise, the tribunal did not find acts of such a state enterprise attributable to the state but a different tribunal found as attributable to the state acts of a limited liability company in which the state indirectly owned 89% of shares.

Articles 4 and 5 of the ILC Articles on State Responsibility were analysed from a public procurement perspective and compared to the approach taken in the respective decisions. The chosen perspective showed state responsibility towards foreign investors for acts of a state enterprise while conducting public procurement proceedings can be found by some arbitral tribunals while dealing with protection of foreign investments. Especially while taking into account the commentary on attribution in the ILC Articles on State Responsibility that "*international law does not permit a State to escape its international responsibilities by a mere process of internal subdivision.*"⁴⁴ With this essential purpose of the ILC Articles on State Responsibility in mind and from public procurement perspective states will be more likely found responsible in relation to Article 4 and Article 5 of the ILC Articles on State Responsibility.

The question of attribution is of fundamental importance because even if from a short term perspective it can be advantageous for a state to waive its responsibility and thus avoid compensation towards the foreign investor, in the long run it can discourage investors from taking part in tendering procedures if the level of their protection is not clear.

The opinion expressed in this paper is that once state establishes a state enterprise which administers state owned property and undertakes to exercise powers originally assigned to the state by law, acts of such an entity should be attributable to the state. Approach of some of the arbitral tribunals does not seem correct if they allow the

⁴⁴ United Nations (2008) Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries, p. 39. Available online at: http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (accessed on 10 December 2015)

state to escape its responsibility by merely assigning its legal duties to an enterprise the state established. Using the reasoning of the tribunal in the InterTrade case, state would be easily able to avoid its responsibility towards foreign investors in a number of tendering procedures only by conducting those through state enterprises or state owned companies. And this does not seem fair.

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Legislation

Act. no 137/2006 Coll. on Public Procurements

Act. no. 77/1997 Coll. on State Enterprise

Treaty between the Federal Republic of Germany and the Czech and Slovak Federal Republic Concerning the Promotion and Reciprocal Protection of Investments

Treaty between the Government of the Kingdom of Morocco and the Government of the Republic of Italy for Reciprocal Promotion and Protection of Investments