

**UMBRELLA CLAUSES IN INTERNATIONAL
INVESTMENT ARBITRATION: ADOPTING A
NARROW OR BROAD INTERPRETATION FOR
MUTUAL PROTECTION OF INVESTORS AND
HOST STATES**

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Abstract

International investment law finds its niche within the significant fields of international arbitration and trade law. The developing importance of foreign investments has grown in modern times and is facilitated by Bilateral Investment Treaties which exist between nations. These treaties have a double-sided objective— on one hand, they promote foreign investments in a host state, and on the other, they envisage to protect rights and interests of the investor who seeks to set up such an investment. A contentious issue, which has been a hot topic of debate over the past decade, pertains to the scope and extent of BIT protections. While one, the broad approach, advocates that BIT protections should be extended to contractual obligations, another approach adopts a more restrictive

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view and asserts that protections under the BIT must extend only to substantive obligations which arise from the treaty itself. The question of elevation of contractual breaches to a treaty breach is dependent on the presence of a so-called umbrella clause in the treaty. The method of interpretation of such a clause is a question which has been placed before several Tribunals, though no single consistent view has emerged as yet.

This paper will analyse the two decisions of ICSID Tribunals in the cases of Société Générale de Surveillance v. Islamic Republic of Pakistan and Société Générale de Surveillance v. Republic of Philippines where the Tribunals opined opposing views— a restrictive view in the former and a broader approach in the latter— and will delve into the reasons as to which approach is more desirable.

I. INTRODUCTION

Investment Arbitration is a burgeoning new field in international arbitration which seems to have emerged as a replacement to the two conventional forms of dispute resolution between an investor and a host State— diplomatic protection and litigation in domestic courts. These two methods have proved to be more or less futile as the needs of one party is generally overlooked. Diplomatic protection offers little remedy to the investor and can be invoked only once all other local remedies have been exhausted by the investor. Litigation in the

host State's domestic courts also lacks the objectivity which an investor seeks mostly due to the fact that domestic laws of the host State would apply and this would be prejudicial against the investor. To meet this procedural gap, international investment arbitration has emerged on the borderline between public international law and domestic law. In the words of Prof. Schreuer, international investment arbitration offers an objective international judicial procedure on the basis of internationally accepted standards that grants direct access to the investor without having to depend on its State of nationality.¹

Any international investment is based on an agreement between two countries, generally in the form of an investment treaty. When the treaty exists between only two countries, it is known as a Bilateral Investment Treaty (BIT) or Bilateral Investment Programme Agreement (BIPA). BITs generally contain an arbitration clause, which is essentially an offer by the State party to eligible investors; it does not, however, establish jurisdiction of a Tribunal by itself. The investor may take up this offer by formally accepting it or merely by instituting proceedings against the host State, which is an implied acceptance.²

An offer of jurisdiction by the host State to the investor gives the investor a wide scope of acceptance— if accepted in narrow terms, the claim may relate only to investment disputes arising out of the BIT itself. On the other hand, if accepted on broader terms, the claim may relate to any other contract incidental to the BIT as well. This sort of acceptance is directly dependent on the presence of an umbrella clause in the BIT and this poses issues regarding the extent of jurisdiction under the BIT of an arbitral Tribunal.

¹Christoph Schreuer, *The Relevance of Public International Law in International Commercial Arbitration: Investment Disputes*, http://www.univie.ac.at/intlaw/pdf/csunpublpaper_1.pdf.

²Tokios Tokeles v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction (Apr. 29, 2004), p. 94-100.

An umbrella clause may be worded in several different ways, hence giving rise to complex scope of interpretation.

Some treaties simply state that ‘each party shall observe any obligation it may have entered into with regard to investments’;³ while some are worded more complex– ‘each Contracting Party shall observe any particular obligation it may have entered into with regard to investments of investors of the other Contracting Party’⁴

Investment treaty arbitrations not only involve BITs, but also investor-State contracts. The extent of jurisdiction under a BIT is never fixed; while some only cover disputes “relating to an obligation under this agreement” (i.e. only claims arising out of the BIT), others may extend to “any dispute relating to investments”, or even a general international law obligation on the part of the host State to “observe any obligation it may have entered into” or “constantly guarantee the observance of the commitments it has entered into”. These clauses which give rise to further obligations for the host State to observe are known as ‘umbrella clauses’ or ‘*pacta sunt servanda*’⁵. Clauses of this kind have been added to BITs to provide extra protection to investors against unfair practices by the host State. These clauses are known as umbrella clauses because they put contractual commitments under the treaties’ protective umbrella.⁶

³Treaty between United States of America and the Kingdom of Morocco Concerning the Encouragement and Reciprocal Protection of Investments of 29 May 1991, Art. 11(3).

⁴Agreement between the Government of Hong Kong and the Government of the Republic of France for the Reciprocal Promotion and Protection of Investments of 30 November 1995, Art. III.

⁵See recognised in the Vienna Convention, Art.26 which states “Every treaty in force is binding upon the parties to it and must be performed by them in good faith”.

⁶Schreuer, *supra* note 1.

A particular act of the host State may constitute a breach of contract as well as a violation of international law.⁷ These two breaches may or may not be mutually exclusive. A state may breach a treaty without breaching the contract or *vice versa*. Whether there has been a breach of the treaty and whether there has been a breach of contract are to be addressed as different issues.⁸ Hence, the jurisdiction of a Tribunal may be invoked in case of contractual breach by the host State in any of the following situations:

- The investor is able to prove that the breach of the contract has amounted to violation of the BIT standards. For e.g. if a contractual breach amounts to expropriation, breach of fair and equitable standards, breach of full protection and security, etc.
- The arbitration clause in the BIT is not only restricted to violations of the BIT but also covers disputes related to investments in general.
- The BIT contains an express umbrella clause, thus converting a breach of contract into a breach of the treaty.⁹

It is always up to the claimant, i.e. the investor, to institute proceedings against the host State on the basis of any kind of violation of rights. However, the first defence sought by the host State before a Tribunal will typically be the lack of jurisdiction on the grounds of an umbrella clause.

Although these umbrella clauses have existed since the 1950s,¹⁰ the first time any such clause was examined and evaluated was with the

⁷Southern Pacific Properties (Middle East) Limited v. Egypt, ICSID Case No. ARB/84/3, Award, (May 20, 1992), p. 164-167.

⁸Vivendi v. Argentina, ICSID Case No. ARB/97/3, Decision on Annulment, (July 3, 2002), p. 95, 96.

⁹Schreuer, *supra* note 1.

¹⁰OECD Working Papers on International Investment 2006/03, Interpretation of the Umbrella Clause in Investment Agreements.

Société Générale de Surveillance, S.A. cases. The two leading cases have resulted in two opposing judgements of the exact same clause by adopting a narrow approach in one and a broad approach in the other. Each approach has been upheld by a series of other Tribunals. The most contentious jurisdictional issue faced by Tribunals is whether and under what circumstances these umbrella clauses place contracts between the host State and the investor under the treaty's protection.

The first ICSID case that addressed the issue of an umbrella clause was that of *Fedax NV v. Republic of Venezuela*¹¹ in 1998, based on a BIT between the Netherlands and the Republic of Venezuela. Although the Tribunal was unaware of the presence of an umbrella clause and did not carry out a comprehensive examination of the clause or its application, it simply gave a plain meaning to the clause and stated that the commitments should be observed under the BIT and to the promissory note contractual document. It further found that Venezuela was under the obligation of “*honour precisely the terms and conditions governing such investment, laid down mainly in Article 3 of the Agreement, as well as to honour the specific payments established in the promissory notes issued.*”¹² The first time a Tribunal actually evaluated the scope, effect and application of an umbrella clause was in 2003 in the case of *SGS v. Pakistan*.¹³ However, shortly after this, the position became uncertain in 2004 with the Decision on Jurisdiction by the Tribunal in *SGS v. Philippines*¹⁴ which provided the opposite interpretation of the clause.

Though they have provided opposing views on the umbrella clause, the final decision of the Tribunals in both the *SGS* cases have been followed in a number of other leading cases. However, before delving

¹¹*Fedax NV v. Republic of Venezuela*, ICSID Case No. ARB/96/3.

¹²*Id.* at 25, 29.

¹³*SGS v. Pakistan*, ICSID Case No. ARB/01/13, (2003).

¹⁴*SGS v. Philippines*, ICSID Case No. ARB/02/6, (2004).

into these cases and an analysis as to which approach is more desirable, it is essential to first study these two individual cases.

II. SIGNIFICANCE OF AN UMBRELLA CLAUSE WITH EMPHASIS ON WORDING AND ITS LOCATION IN A BIT

The most controversial issue with regard to umbrella clauses is whether, and under what circumstances, they place contracts between a host State and an investor under the protection of the BIT existing between the host State and the home State of the investor.

A typical modern umbrella clause is found in the British Model Treaty, which reads-

“Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party.”

The language of the umbrella clause in both the German Model Treaty and the Energy Charter Treaty are identical; while the NAFTA Agreement does not even contain such a clause, neither does the 2004 US Model Treaty nor the French Model Treaty. Moreover, the wording of umbrella clauses in treaties is not uniform. Some treaties simply state-

*“Each Party shall observe any obligation it may have entered into with regard to investments.”*¹⁵

On the other hand, some clauses may be worded more complex- “... *each Contracting Party shall observe any particular observation it may have entered into with regard to investments of investors of the*

¹⁵USA Treaty, *supra* note 3.

other Contracting Party, including provisions more favourable than those of this Agreement.”¹⁶

It is quite evident that there is a disparity in the language used in umbrella clauses in different investment treaties. This directly implies that the specific wording of the clause is crucial to determine its scope, effect and extent of application. Any minute loophole may be identified in the clause and hence used by the claimant to assert the Tribunal’s jurisdiction or conversely, may be used by the host State to evade jurisdiction.

Almost all umbrella clauses reflect the intention of the parties to include within the protection of the BIT, all obligations undertaken by the State. Moreover, the mandatory nature of the clause is a commonality between all BITs.

*“Each Contracting Party shall observe any obligation...”*¹⁷

*“A Contracting Party shall, subject to its law, do all in its power to ensure that a written undertaking...”*¹⁸

The presence of such clauses gives rise to the chief issue in any jurisdiction proceedings- whether a breach of contract may be elevated to a breach of treaty, for breach of an obligation mentioned in the said clause.

The placement of an umbrella clause within the BIT has been a point of variance in the treaty practice. This may even play a role in determining which approach— broad or narrow— to utilise in order to interpret the clause. The common practice is usually one the following three:

¹⁶Hong Kong Treaty, *supra* note 4.

¹⁷German Model BIT 1991(2), Art. 8(2); British Model Treaty; Germany-Pakistan BIT 1959, Art. 7; US-Senegal BIT; US-Panama BIT; UK-Egypt BIT 1975.

¹⁸Australia- Poland BIT 1991, Art. 10.

- Within an article that specifies all the substantive protections under the treaty, such as the Netherlands Model BIT¹⁹ as well as several BITs concluded by the United Kingdom, New Zealand, Japan, Sweden and the US.
- Within a separate provision entitled “other commitments”, which separates it from the substantive provisions by dispute resolution clauses as well as a subrogation clause. A majority of BITs concluded by Switzerland follow this framework, such as the Mexico-Switzerland BIT 1995 in addition to BITs concluded by Mexico.²⁰
- Within a separate provision altogether, separate from the substantive protections, but before the dispute resolution clauses. This structure has been followed in the German Model BITs.²¹

It is still uncertain as to the effect of the placement of the umbrella clause in the overall framework of a BIT. For instance, the International Centre for Settlement of Investment Disputes (ICSID) Tribunal in *SGS Société Générale de Surveillance S.A. v Islamic Republic of Pakistan*²² was of the opinion the placement of the umbrella clause near the end of the Switzerland-Pakistan BIT indicated that it was the intention of the Contracting Parties not to provide a substantive obligation and if they intended to do so, they could have done so by placing it along with the other ‘first order’ obligations.²³ On the other hand, the Tribunal in *SGS Société Générale de Surveillance S.A. v. Philippines*²⁴ opined that although

¹⁹Netherlands Model BIT, Art. 3.

²⁰France-Mexico BIT 1998, Mexico-Switzerland BIT 1995, Belgium and Luxembourg-Mexico BIT 1998.

²¹German Model BIT, Art. 8.

²²SGS Pakistan, *supra* note 13.

²³*Id.* at 170.

²⁴SGS Philippines, *supra* note 14.

the placement of the clause may be “*entitled to some weight*”²⁵, it still did not consider this factor vital enough to utilise in its interpretation.

The natural argument of any investor while invoking jurisdiction under the BIT is that the host country’s consent extends to all the treaty provisions, including the umbrella clause, and that the investor-state contract is one of the obligations or commitments that the host State is obligated to observe under this clause. A Tribunal is hence faced with the question of whether or not the investor has a double-sided claim— the primary substantive BIT claim and second, the contract claim that is elevated to a treaty claim by virtue of the umbrella clause. The significance of the umbrella clause is that it potentially tilts the debate in favour of the investor and impliedly burdens the host state to demonstrate that an investor-state contract is not one of the obligations or commitments encompassed by the umbrella clause. This was the exact issues faced by the Tribunals in both *SGS v. Pakistan*²⁶ and *SGS v. Philippines*²⁷ – whether the consent in the BIT extends to contract-based claims in addition to treaty-based claims.

III. ANALYSIS OF SGS CASES

The SGS cases are the two most landmark cases where Tribunals were faced with the issue of deciding the scope of an umbrella clause. An interesting fact is that both Tribunals adopted two completely opposing views as to the interpretation of very similar clause, from the Pakistan-Switzerland BIT²⁸ and the Philippines-Switzerland BIT²⁹.

²⁵*Id.* at 124.

²⁶*SGS Pakistan*, *supra* note 23, at 170.

²⁷*SGS Philippines*, *supra* note 25, at 124.

²⁸Agreement between the Swiss Confederation and the Islamic Republic of Pakistan on the Promotion and Reciprocal Protection of Investments, Art. 11.

Both decisions have been adopted in several other cases in the following years, but the debate as to which method is more desirable continues till date.

A. *SGS (Société Générale De Surveillance S.A.) v. Islamic Republic Of Pakistan*³⁰

An ICSID Tribunal, in this landmark case, adopted a narrow or restrictive view of interpreting the umbrella clause and finally rejected jurisdiction over the contract claims. The Tribunal did nevertheless accept jurisdiction over the BIT claims; however, only the former is relevant for the current analysis. Before going into the reasoning of the Tribunal, a brief background of the case is necessary to understand the same.

The dispute between SGS Société Générale de Surveillance S.A. and the Government of Pakistan arose from a Pre-Shipment Inspection (PSI) Agreement signed by both parties on 29 September 1994, whereby both parties agreed that SGS would provide pre-shipment inspection services with respect to goods to be exported from certain countries to Pakistan.³¹ After around two years, Pakistan notified SGS that the contract would be terminated. After communications between the parties failed, SGS filed a suit in the domestic court of Switzerland against Pakistan. However, Pakistan successfully argued that as per the PSI Agreement, the parties had chosen to arbitrate any disputes arising out of the contract before an arbitral tribunal in Pakistan.³² Meanwhile, Pakistan had instituted arbitral proceedings as per the Agreement; SGS, however, objected to the PSI Agreement arbitration, and in addition filed counter-claims against Pakistan for

²⁹Agreement between the Swiss Confederation and the Republic of Philippines on the Promotion and Reciprocal Protection of Investments of 1997, Art. X (2).

³⁰SGS Pakistan, *supra* note 13.

³¹*Id.* at 11.

³²*Id.* at 22-25.

alleged breaches.³³ Six months later, SGS notified Pakistan that it was invoking Article 9(2) of the Switzerland-Pakistan BIT, the dispute resolution clause, providing for ICSID arbitration.³⁴

Amongst several alleged claims under the BIT such as failure to ensure fair and equitable treatment of SGS' investment and measures amounting to expropriation without providing fair and adequate compensation, the most contentious issue of the arbitration was with respect the umbrella clause contained in Article 11 of the BIT. SGS' assertion was that Pakistan violated the said Article by failing to guarantee observance of its contractual commitments. Article 11 of the BIT reads—

*“Either Contracting Party shall constantly guarantee the observance of commitments it has entered into with respect to the investments of investors of the other Contracting Party.”*³⁵

SGS contended that contractual claims come within the ambit of the BIT and therefore the ICSID Tribunal should decide on the contractual claims in addition to the purely BIT claims. Pakistan's major objections were that the ICSID Tribunal could not have jurisdiction when the parties have expressly agreed to submit disputes elsewhere and that the Tribunal could not investigate the claims under Article 11 until the Pakistan arbitral tribunal had first determined whether or not there was in fact a contractual breach.³⁶ SGS further insisted that the umbrella clause effectively 'elevates' the purely contractual claims to the level of claims of a breach of Treaty.³⁷

³³*Id.* at 26-27.

³⁴*Id.* at 32.

³⁵*Id.* at 97.

³⁶*Id.* at 48-49.

³⁷*Id.* at 54.

The Tribunal rejected the argument that Art.11 of the BIT elevated a mere contractual breach to a treaty breach. The primary explanation afforded by the Tribunal was that in principle, a breach of contract could not amount to a breach of international law. Moreover, the legal consequences of the approach adopted by the claimant in order to interpret Art.11 were held by the Tribunal to be “*so far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party*”. They further stated that in order to provide such an effect to the said Article, there must be clear and convincing evidence of the shared intent of both Contracting Parties in incorporating the Article, which is absent in this case.³⁸

The Tribunal presented four arguments in support of their proposition. First, that the broader view of the clause would also cover non-contractual obligations arising under the laws of the host state, including the smallest types of commitments and would thus lead to a flood of lawsuits before international tribunals. Second, it would amount to incorporating an unlimited number of State contracts as well as other municipal law instruments setting out State commitments, including unilateral commitments, to an investor of the other Contracting Party. Third, the Tribunal considered that the location of the umbrella clause towards the end of the treaty as separate and distinct from the substantive obligations further showed the intention of the parties to not include it as a substantive treaty obligation. And finally, it pointed out that the benefits of the dispute settlement provisions of the contract would clearly flow to the investor. The State’s invocation of the contractually specified forum could easily be defeated by the investor, who would in turn have the

³⁸*Id.* at 167.

choice of forum selection either under the BIT or the specific contract.³⁹

The claimant finally contended that without a liberal application of this clause, it would be rendered completely useless. Again, the Tribunal rejected this argument and stated that under exceptional circumstances, a violation of certain provisions of a contract between an investor and a state might also amount to a treaty violation by infringing a clause. For instance, in a case where a State takes steps to impede the ability of the investor to pursue its claims under the contract's dispute resolution clause, or if they refused to go to arbitration at all leading to blatant denial of justice.⁴⁰

Therefore, ultimately, the Tribunal narrowly construed the umbrella clause in Art.11.1 of the BIT and stated that contractual disputes could not be elevated to a treaty claim unless in exceptional circumstances.

*B. SGS Société Générale De Surveillance S.A.) v. Republic Of
Philippines⁴¹*

In this case also, the contractual relationship giving rise to the dispute between SGS and the Philippines was similar to that in the previous case. In 1991, the two parties entered into a contract, known as the Comprehensive Import Supervision Service (CISS) Agreement, by which SGS would provide pre-shipment inspection services of the imports to Philippines, including verification of the imported goods' quality, quantity and price.⁴² From 1986-1998, new agreements were entered into and after 1998, the CISS Agreement was extended

³⁹Id. at 166, 168-169.

⁴⁰Id. at 172.

⁴¹SGS Philippines, supra note 14.

⁴²Id. at 12-13.

twice.⁴³ In 2000, SGS' services under the Agreement were discontinued; following which SGS submitted claims to the Philippines for money unpaid on the contract, a total amounting to approximately US \$140 million plus interest.⁴⁴

When attempts for amicable settlement failed, SGS submitted a request for arbitration to ICSID, invoking the dispute resolution clause in the Switzerland-Philippines BIT, contending breach of fair and equitable treatment, expropriation as well as breach of the host state's obligations under the umbrella clause in Article X(2) of the BIT.⁴⁵ The Philippines, denying jurisdiction of the tribunal, argued that the dispute was purely contractual in nature and therefore subject to the forum selection clause i.e. Article 12 in the CISS agreement, which required disputes to be heard before the domestic courts of the Philippines.⁴⁶ Further, the Philippines relied on the decision in *SGS v. Pakistan*, contending that an umbrella clause was insufficient to transform a contract claim to a treaty claim.

In response, SGS argued that the ICSID's jurisdiction was found in Article 25(1)⁴⁷ of the ICSID Convention, which provided for jurisdiction over a legal dispute arising directly out of an investment when there is express consent by the parties in writing— which in this case, is the Switzerland-Philippines BIT⁴⁸— and therefore the tribunal has jurisdiction over contractual claims arising *inter alia* out of the umbrella clause. Article X (2) reads—

⁴³*Id.* at 13-14.

⁴⁴*Id.* at 14-15.

⁴⁵*Id.* at 16.

⁴⁶*Id.* at 17, 22.

⁴⁷Convention on the settlement of investment disputes between States and nationals of other States art 25(1), adopted Mar. 18, 1965, 575 U.N.T.S 159.

⁴⁸*Id.* at 16, 46.

*“Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party.”*⁴⁹

SGS primarily argued that the effect of an umbrella clause is to elevate a breach of contract to a treaty claim under international law, while maintaining that the tribunal may consider contractual issues in determining claims based on a BIT, even if they have different legal bases.⁵⁰ While acknowledging the conclusion of the tribunal in *SGS v. Pakistan* which only recognised accepting jurisdiction over contractual claims in exceptional circumstances, the *SGS v. Philippines* tribunal contrasted the differences in the umbrella clauses in the two BITs. It held the wording of Article X (2) to be more clear and specific.⁵¹

The tribunal offered a few arguments in support of this broad interpretation of the umbrella clause. First, the text of the provision is phrased in mandatory language by using the word ‘shall’, just as in other substantive provisions imposing obligations on the parties. Further, the tribunal stated that the phrase ‘any obligation’ is wide enough to include obligations arising under national law with regard to an investor-state contract.⁵² The tribunal went on to state that on interpreting the actual text of the clause, it would appear that each Party to the BIT must observe any legal obligation it has assumed, or will assume in the future, with respect to specific investments covered under the BIT.⁵³

Second, any uncertainty regarding the scope of Article X(2) should be resolved in favour of protecting investments, since this is the

⁴⁹*Id.* at 34.

⁵⁰*Id.* at 64-65.

⁵¹*Id.* at 119-120.

⁵²*Id.* at 115.

⁵³*Id.* at 115.

overriding purpose of a BIT.⁵⁴ Moreover, for binding obligation or commitments of the state, such as investor-state contracts, to be brought within the framework of the said Article is consistent with the object and purpose of the BIT.⁵⁵ Finally, the tribunal opined that if the parties had intended to limit the umbrella clause to only certain kinds of obligations, they were free to stipulate such restrictions in the BIT, but did not do so.⁵⁶

The tribunal clearly addressed the justification and reasoning provided by the tribunal in *SGS v. Pakistan* and stated its differing opinion for certain reasons. Of them, one was with respect to the location of the umbrella clause in the BIT, the tribunal did not agree with the former tribunal that this was a decisive factor in determining jurisdiction.⁵⁷ In addition, the tribunal addressed the concern of the *SGS v. Pakistan* tribunal regarding the detrimental effect a broad interpretation would have of overriding the dispute settlement clause in investor-state contracts. While agreeing with this concern, the tribunal refused to accept that this effect would flow from a broad interpretation of the umbrella clause.⁵⁸ While dealing with whether the forum selection clause of the Agreement was overridden by the BIT, the tribunal gave two reasons for its disagreement. Firstly, the general wording of the provision makes it applicable to investment agreements, whether concluded prior to or after the entry into force of the Agreement. It therefore cannot be presumed that the general provision has the effect of overriding specific provisions of particular contracts, which are freely negotiated by the parties. The second consideration derives from the character of an investment protection agreement as a framework treaty in tended to support and supplement

⁵⁴*Id.* at 116.

⁵⁵*Id.* at 117.

⁵⁶*Id.* at 118.

⁵⁷*Id.* at 124.

⁵⁸*Id.* at 123.

the negotiated investment agreements between host state and investor, not to override or replace them.⁵⁹

C. Evolution Of Later Judgements

Since the ICSID tribunal in 2003 decided the case of *SGS v. Pakistan*, several others have chosen to follow suit. The position taken by *SGS v. Pakistan* has been supported by several ICSID tribunals. One such is *Joy Mining v. Egypt* where the tribunal found that an umbrella clause not prominently inserted into a BIT cannot operate to transform a contract claim to a treaty claim, unless there exists a clear violation of the rights and obligations under the treaty, or the contractual breach is of such magnitude that it may trigger the Treaty protection.⁶⁰ The tribunal held that there was a missing link between the contract and the treaty that would prompt treaty protection and an umbrella clause is insufficient for the same.⁶¹

In another case of *CMS v. Argentina*, analyzing the Argentina-United States BIT, the tribunal opined that not all contract breaches result in breaches of the Treaty, even when there is an umbrella clause present.⁶² While treaty protection is not available to purely commercial aspects of a contract, the umbrella clause may elevate a contract claim to a treaty claim only when there is significant interference by the government or public agencies with the rights of the investor.⁶³

⁵⁹*Id.* at 141.

⁶⁰*Joy Mining Mach. Ltd. v. Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, (Aug. 6, 2004), 81.

⁶¹*Id.* at 81.

⁶²*CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, (May 12, 2005), 299.

⁶³*Id.* at 299.

The decision was followed again in 2006 by two nearly identical cases- *El Paso v. Argentina* and *Pan American v. Argentina*⁶⁴also followed *SGS v. Pakistan*'s narrow interpretation of the umbrella clause in interpreting the United States-Argentina BIT. While agreeing with the arguments put forth by the *SGS v. Pakistan* tribunal, the *El Paso* tribunal further added that a narrow reading of the umbrella clause was necessary to prevent a state's minor commitments from being transposed to international treaty obligations.⁶⁵

Several other ICSID tribunals have, on the other hand, chosen to follow the approach of *SGS v. Philippines*. For instance, in *L.E.S.I.-DIPENTA v. Algeria*, the tribunal in 2005 accepted jurisdiction over a contractual claim on account of a BIT umbrella clause.⁶⁶ Again in 2005, *Eureko B.V. v. Poland* laid importance the imperative wording and broad scope of the BIT as determining factors in finding that a BIT encompassed all of a state's obligations, including investor-state contracts.⁶⁷ The tribunal in *Sempra Energy International v. Argentina* found that certain claims were simultaneously contract claims and treaty claims and the connection between the two was strengthened by the umbrella clause. The tribunal favoured the *SGS v. Philippines* approach based on the Treaty, the contract and the context of the investment.⁶⁸

⁶⁴*Pan American BP v. Argentina*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections, (July 27, 2006).

⁶⁵*El Paso Energy International Company v. Argentina Republic*, ICSID Case No. ARB/3/15, Decision on Jurisdiction, (2006), 76.

⁶⁶*Consortio Groupement L.E.S.I.-DIPENTA v. People's Democratic Republic of Algeria*, ICSID Case No. ARB/03/8, Award, (Jan. 10, 2005).

⁶⁷*Eureko B.V. v. Republic of Poland*, Partial Award on Liability, (Aug. 19, 2005), 255.

⁶⁸*Sempra Energy International v. Argentine Republic*, (2005), Decision of the Tribunal on Objections to Jurisdiction, ICSID Case No. ARB/02/16, 101.

The *Noble Ventures v. Romania* tribunal decided that an umbrella clause clearly references contracts entered into between the host state and investor.⁶⁹ The tribunal insisted on the specificity of each umbrella clause, and emphasized that the wording in the umbrella clause very clearly referred to investment contracts.⁷⁰ In addition, the tribunal emphasized the object and purpose of investment treaties as consistent with Article 31 of the Vienna Convention.⁷¹

IV. WHICH APPROACH IS MORE DESIRABLE?

While considering which approach would be more desirable, the primary requirement would be to peruse the BIT as a whole, rather than isolate an individual clause and scrutinise it independently. It is imperative to understand the object and purpose of a treaty to get a comprehensive understanding of the same. It can be reasonably assumed that the purpose of most investment treaties is tied to the desirability of foreign investments, which could mutually benefit both the host state and the investor investing in the state. It would seek to provide conditions necessary for promotion of foreign investment and conversely provide an environment to channel in more foreign investment into the host state. The Vienna Convention,⁷² in Article 31, lays down rules for interpretation. These rules include the object and purpose of the treaty along with good faith.⁷³ Tribunals have generally interpreted treaties in light of their object and purpose by

⁶⁹*Nobel Ventures Incorporated v. Romania*, (2005), ICSID Case No. ARB/01/11, Award, (Oct. 12, 2005), 59.

⁷⁰*Id.* at 51.

⁷¹Vienna Convention on the Law of Treaties, adopted on 23 May 1969, 1155 U.N.T.S. 331.

⁷²*Id.*

⁷³“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”, Art. 31, Vienna Convention on the Law of Treaties.

referring to their preambles. The purpose of an investment treaty as highlighted in the preamble is to promote the mutual protection of investments and to draw attention to the nexus between an investment-friendly environment and the flow of foreign investment.

At the outset, the author deviates from the approach of both SGS tribunals while interpreting the respective umbrella clauses. In each case, the tribunal has perused the clause as it is, with very fleeting references to the object and purpose of the entire BIT. The tribunals have isolated the umbrella clause and have read it as it is, breaking up the clause into segments and laying varying degrees of significance on each. Rather than reading the single umbrella clause in isolation, the authors advocate interpretation along the lines of the VCLT. Strict adherence to Article 31 of the VCLT lays utmost importance on the object and purpose of the BIT while deciding which approach to adopt while interpreting an umbrella clause.

Having established the foundation of interpretation— the object and purpose of the BIT— which is to mutually promote and protect investments, the approach adopted in *SGS v. Philippines* is more desirable than that adopted in *SGS v. Pakistan* in the opinion of the authors. Before validating the *Philippines* tribunal, the authors will first set out the points of disagreement with the *Pakistan* tribunal and the reasons for the same.

The first issue to address is with respect to the placement of the umbrella clause in the treaty. The *Pakistan* tribunal opined that the location of the umbrella clause towards the end if the BIT was significant in determining the intent of the Parties. The tribunal stated that since the umbrella clause was placed away from the other substantive obligations, it cannot be considered a ‘first order’ obligation. Moreover, the reasoning of the tribunal was that since the substantive provisions were separated from the umbrella clause by a subrogation clause as well as the dispute resolution provisions, the

Article was not meant to set out a substantive obligation.⁷⁴ While the reasoning is appreciated, the authors disagree with the significance laid upon the position of the umbrella clause. Even if the obligations under an umbrella clause are not considered as ‘first order’ obligations, they may be classified as supplementary or incidental obligations, which are still entitled to protection under the BIT, irrespective of its position amid the arrangement of sections.

The next issue is with regard to the *Pakistan* tribunal’s reason that the legal consequences of a broad approach would be ‘so far-reaching in scope’ and ‘so burdensome in their potential impact upon a Contracting Party’. The tribunal went on to state that the broad interpretation would encompass non-contractual obligations, including an unlimited number of State contracts as well as other municipal law instruments setting out several State commitments. In the authors’ opinion, this reasoning of the tribunal is flawed. Primarily, adopting a broad approach to interpreting an umbrella clause does not necessarily imply opening the avenue for every obligation the State has entered into. A broad approach advocated by the claimants and then the *Philippines* tribunal merely suggests that contracts entered into between an investor and the host State must be honoured and given treaty protection; it does not suggest providing treaty protections to each and every obligation of the State. These protected obligations would extend only to contracts between that particular investor, i.e. the claimant in the case in progress, and the host State, with respect to certain investments. Moreover, by virtue of the existence of a BIT between the investor’s country and the host State, such investors are in any case entitled to protection under the Treaty.

The *Pakistan* tribunal has also thrown light on the possibility of misuse of the forum selection clause by the investor, as the investor

⁷⁴SGS Pakistan, *supra* note 13.

benefits from the choice of forum selection under both the BIT and the contract. The tribunal has addressed a valid concern at this juncture, but the authors find insufficiency to refuse jurisdiction based on this one concern.

The tribunal finally states that the umbrella clause must be invoked only in exceptional circumstances. Again, the authors disagree with this assertion as the almost complete neglect of a clause in a treaty is completely irrational. The drafting and insertion of the clause would be completely pointless if there were such few circumstances in which it could be invoked. Keeping in mind the object and purpose of a BIT, overlooking an umbrella clause in the lack of any exceptional case, would defeat the presence of such a clause.

The sound reasoning and fulfilment of the purpose of the BIT leads the authors to believe that the approach of the *Philippines* tribunal is more desirable as it successfully protects an investment and allows overall protection of rights of the investors. Moreover, the wording of the umbrella clause implies that observance of all kinds of obligations, whether within the treaty or a contractual obligation are necessarily to be complied with. While adopting the broad interpretation, investments are being protected and the rights of the host state are being hindered in no way. In fact, it would be more desirable for a tribunal constituted under the BIT dispute resolution clause to entertain contractual breaches, amounting to treaty breaches. This would in turn save large amounts of money and time of the parties.

Furthermore, while entering into BITs, Contracting Parties have the option of expressly excluding certain kinds of obligations/commitments from the purview of an umbrella clause. Failure to exercise this right at the time of entering into the BIT cannot then be sought as a defence when the investor invokes jurisdiction under the umbrella clause. Moreover, contracts between an investor and a host state are signed after a BIT exists between the

two countries in most cases. At the time of entering into the contract also, parties have the option of specifying certain grounds when the jurisdiction under the forum-selection clause of the contract may be invoked.

At this point, the concern regarding the overriding effect of the broad approach over the forum-selection clause must be addressed. It is important to note that the mere presence of an umbrella clause in a BIT does not by default eliminate the forum-selection clause in the contract. This clause can certainly be invoked in cases where a contractual breach does not amount to a treaty breach. Although the protection under the treaty is available when there is significant interference of the rights of the investor under the treaty, purely commercial aspects of a contract might not be protected by the treaty. The umbrella clause in the BIT is a general protection afforded to an investor in case a contractual claim violation of treaty rights. This however does not obliterate the validity of the specific forum-selection clause in the contract in case of disputes arising out of the contract. Therefore, there exists no possibility of an overriding effect of an umbrella clause over the contract's forum-selection clause.

V. CONCLUSION

As can be seen from the abovementioned cases, the approach of tribunals to interpreting an umbrella clause has fluctuated between both the broad and restrictive views. There exists no fixed rule for such interpretation till date. Tribunals are still given the discretionary power to rule on their jurisdiction based on their own perusal of the clauses in the BIT. The terminological difference between 'treaty claims' and 'contract claims' is widely utilised by tribunals to understand what breaches are purely commercial and contractual in nature and what infringements are blatant violations of the treaty. The

crucial determining factor at this point is whether a contract claim amounts to a treaty claim by virtue of the presence of the umbrella clause in the BIT.

Keeping in mind the overall interests of an investor making an investment in the host state, relying on the obligations promised by the latter through the existing bilateral investment treaty, a tribunal must ideally adopt a wider interpretation to an umbrella clause, thus bringing within its ambit contract breaches that lead to treaty violations.