

**UMBRELLA CLAUSES: A JURISPRUDENTIAL ANALYSIS  
UNDER THE MODERN DAY BILATERAL INVESTMENT  
TREATIES**

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*Abstract*

*With the sudden proliferation of BITs in the last decade the problem of umbrella clauses which has far now been the most controversial area in the domain of international investment arbitration has bloomed with majority of BITs featuring umbrella clauses. We have gone into a brief history of the clause and traced its working from its origin to the modern day system of BITs. Through these clauses, investors have elevated contract breaches into international obligations, and have received the protection for their investments against the host states. The tribunals all around the globe seem to be divided on the issue of interpretation of the clause, and there is yet no predictability over the matter. The paper also talks about the role of sub-state entities in the investment agreements. This paper analyses the role of host state in bestowing authority to its instrumentalities to execute investment contracts with the investors. The municipal law on this issue is regarded of high relevance and is considered to be the last resort in dispute settlement. This paper also deals with the principle of privity of contract in the light of the investment arbitration since arbitration is*

*deemed to be a creature of consent. It also delves into the rights and obligations of the subsidiaries of the investing parties and their stakes into domestic companies of host State. This paper clearly depicts umbrella clauses as a modern day tool for investors against the host State, which is a party to a bilateral investment treaty.*

## I. INTRODUCTION TO UMBRELLA CLAUSES

There has been a growing uncertainty to the term ‘Umbrella clauses’ which have been found in multiple Bilateral Investment Treaties (BIT). To put it succinctly, umbrella clauses create mutual international obligations to be indebted by the contracting states that compel them, as host states, to respect the obligations they have entered into, with the investors from other contracting state or their investments. However there has been an array of disputes over the proper construction of umbrella clauses and has become a bone of contention in a number of recent International Centre for Settlement of Investment Disputes (ICSID) cases. But before we move on to the meaning, structure and implications of umbrella clauses, it is imperative to understand what exactly Bilateral Investment Treaties (BIT) are and how they have changed the face of international investment law over the past few decades.

BITs have proliferated over the past decade and have gradually changed the way of international investment disputes from diplomatic interventions and domestic law suits to international arbitration. The BIT aims to magnetize foreign investment by giving broad rights to potential investors and creating pliancy in the intention to solve investment disputes. BITs are one of the most commonly used international agreement for protecting and swaying foreign investment. In the past decade there have been over 1500 BITs being concluded by various countries bringing the number of total BITs to 2400. It comes as no

surprise that the emotion-charged increase in number of BITs has led to a surge of arbitration involving investment treaties.<sup>1</sup>

Generally the contents of a BIT differ from each other and even if a country would like to impose its own idea of a model BIT the fluctuating negotiation strength of the other contracting party has the culminating effect of rendering most countries' model BIT heterogeneous. It is so to say that reach and fibre of third party ingress to international arbitration through the BIT apparatus is so varied from one BIT to the other one that it is very onerous to speak of a dominant custom, hence every BIT must be examined on its own merit.

Under a model BIT the most prevalent customary protections of international investment laws are generally marshalled and further strengthened. This gives freedom to investors to make claims directly against the host state. The disputes arising out of the BIT are governed by the mechanism provided in the BIT. Nonetheless the status quo is more complicated. This is so, because of the existence of 'umbrella clauses' which have become widespread in the recent BITs that have come into existence.<sup>2</sup> The stretch of subject matter jurisdiction has not been constant under Bilateral Investment Treaties (BITs).

A few BITs engage only disputes in relation with "obligation under this agreement", i.e., only claims for violation under the BIT. Others enlarge the jurisdiction to "all dispute relating to investments". While some have created an international law responsibility towards the host state, they shall, to simplify, "observe all obligation it may have entered to"; "constantly guarantee the observance of the commitments it has entered

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<sup>1</sup>Stanimir A. Alexandrov, *Breaches of Contract and Breaches of Treaty – The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, 5 J. WORLD INVESTMENT & TRADE 555 (2004).

<sup>2</sup>RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* (Martinus Nijhoff Publishers, 1995).

into”; “observe any obligation it has assumed”, and other formation, in respect to investments.<sup>3</sup>

These set of principles are commonly called “umbrella clauses”, although other formulations have also been used: “elevator”, “mirror effect”, “parallel effect”, “sanctity of contract”, “respect clause” and “*pacta sunt servanda*”. Clauses of this kind have been added to provide additional protection to investors and are directed at covering investment agreements that host countries frequently conclude with foreign investors.

## II. ROOTS IN HISTORY AND THE CONTEMPORARY USE OF THE CLAUSE

Umbrella clauses have become a rather efficient feature of international investment agreements and have been incorporated to provide extra protection to investors by including all contractual duties in investment agreements between foreign investors and host countries. Umbrella clauses over the past have become very controversial and a subject of debate, with international arbitral tribunals.

The scheme behind the figure of speech, that is, the umbrella clause is that an umbrella clause protects in other respect independent investment arrangements between a Contracting State and private investors from the other Contracting State under the treaty’s “umbrella of protection.”<sup>4</sup> Inter-state obligations between contracting parties to observe investment agreements is the purpose of umbrella clauses which may be invoked by the investors when the BIT provides a direct recourse to arbitration.

It is unclear under general international law whether it will qualify as a breach of international law when a state breaches a contract with the

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<sup>3</sup>Thomas W. Walde, *The Umbrella Clause in Investment Arbitration – A Comment on Original Intentions and Recent Cases*, 6 THE JOURNAL OF WORLD INVESTMENT AND TRADE (2005).

<sup>4</sup>Elihu Lauterpacht, *International Law and Private Foreign Investment*, 4 IND. J. GLOBAL LEGAL STUD. 259, 271-72 (1997).

investor.<sup>5</sup> As such a breach may be construed as a normal domestic commercial case. This is precisely the reason why umbrella clauses first arose, when investors had no choice but to resolve their disputes over their contracts in the municipal courts of the host state under its own domestic laws, which were susceptible to unilateral variation by the state.

Origins of umbrella clauses have been traced by scholars to a 1954 draft settlement agreement involving the Anglo-Iranian Oil Company's (AIOC) claims regarding Iran's oil nationalization program<sup>6</sup> The Abs-Shawcross Draft Convention of Investments Abroad (Abs-Shawcross Draft)<sup>7</sup> is a private effort to make a blueprint of rules for the protection of foreign investments. The Abs-Shawcross Draft was created by European lawyers to address the kinds of disputes that confronted AIOC.

Article II of the Abs-Shawcross Draft, umbrella clause states: "*Each party shall at all times ensure the observance of any undertakings which it may have given in relation to investments made by nationals of any other Party.*"<sup>8</sup> This clause in particular is applicable not just to one single agreement but to all investment commitments undertaken by each state party towards investors from any other state party. This made way for umbrella clauses to evolve and to resemble the umbrella clauses that we find today in the modern BITs.

#### *A. The evolution of the clause in early stages*

The umbrella clauses first appeared<sup>9</sup> as a unique protection clause in 1956-59 Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries:<sup>10</sup>

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<sup>5</sup>LASSO OPPENHEIM, SIR ROBERT JENNINGS & SIR ARTHUR WATTS, OPPENHEIM'S INTERNATIONAL LAW 927 (9th ed. Longman, 1992).

<sup>6</sup>Anglo-Iranian Oil Co. Ltd. (U.K. v. Iran), (1952) ICJ 2.

<sup>7</sup>The text of the Abs-Shawcross Draft Convention/Draft Convention on Investments Abroad is reprinted in The Proposed Convention to Protect Private Foreign Investment: A Round Table, 9 J. PUB. L. 115, 116-18 (1960).

<sup>8</sup>Abs-Shawcross Draft Convention on Investments Abroad, art. 2.

<sup>9</sup>A.C. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 ARBITRATION INTERNATIONAL 411, 411-434 (2004).

*“In so far as better treatment is promised to non-nationals than to nationals either under inter-governmental or other agreements or by administrative decrees of one of the High contracting Parties, including most-favoured nation clauses, such promises shall prevail.”*<sup>11</sup>

Moreover the Abs-Shawcross Draft included all contractual investment obligations within its ambit including such obligation, between a foreign private investor and a state, since an ‘undertaking’ is construed to be broader than a contract and thus covers obligations arising out of a contract. Legal scholars like Fatouros, commented on Article II that, it was *“meant to cover the cases of contractual commitments of states to aliens,”*<sup>12</sup> and Schwarzenberger noted that it *“covers undertakings by contracting parties both to subjects and objects of international law.”*<sup>13</sup>

This outlook went through an overhaul in the 1959 Abs-Shawcross Draft Convention on Foreign Investment, Article II:

*“Each Party shall at all times ensure the observance of any undertakings which it may have given in relation to investments made by nationals of any other party.”*<sup>14</sup>

The clause made an appearance again in the first ever BIT between Pakistan and Germany in 1959, Article 7:

*“Either Party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other party.”*<sup>15</sup>

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<sup>10</sup>See H.J. Abs, *Proposals for Improving the Protection of Private Foreign Investments*, IN INSTITUT INTERNATIONALE D’ÉTUDES BANCAIRES (1958).

<sup>11</sup>Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries, 1956-59, art 4.

<sup>12</sup>Arghyrios A. Fatouros, *An International Code to Protect Private Investment—Proposals and Perspectives*, 14 U. TORONTO L.J. 77, 88 (1961).

<sup>13</sup>Georg Schwarzenberger, *The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary*, 9 J. PUB. L. 147, 154 (1960).

<sup>14</sup>Abs-Shawcross Draft Convention on Investments Abroad, art. 2.

<sup>15</sup>Treaty for the Promotion and Protection of Investments, F.R.G.-Pak., Nov. 25, 1959, 457 U.N.T.S. 23, 28-29 (1963).

It also appeared in the core substantive rules of the OECD Draft Convention on the Protection of Foreign Property, 1967, Article 2 which stated that:

*“Each Party shall at all times ensure the observance of undertakings given by it in relation to property of nationals of any other Party.”*<sup>16</sup>

Even though the OECD Draft pen ultimately did not get a majority, the OECD Council resolved at its 150th Meeting in 1967 to suggest the draft convention to member states as a prototype for their own BITs and as a general pronouncement of international law rules pertinent to foreign investment.<sup>17</sup>

### III. SIGNIFICANCE OF THE CLAUSE IN INVESTMENT ARBITRATION

Now that we have a general understanding of how umbrella clauses emerged and worked their way through the functioning of the modern day BITs and have become a seminal feature of today’s international investment law, let us try to understand, what they exactly are and how they work.

To put it simply the umbrella clause is an international law obligation created by treaty, that a host State shall 'observe any obligation it may have entered into', 'constantly guarantee the observance of the commitments it has entered into', 'observe any obligation it has assumed', and other variants.

The first umbrella clause which found its way in the a BIT was the Pakistan-Germany BIT of 1959.<sup>18</sup> Article 7 of the Pakistan-Germany BIT

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<sup>16</sup>Draft Convention On The Protection Of Foreign Property And Resolution Of The Council Of The OECD On the Draft Convention, OECD Publication No. 23081 (1967).

<sup>17</sup>*Id.*

<sup>18</sup>Treaty for the Promotion and Protection of Investments, F.R.G.-Pak., Nov. 25, 1959, 457 U.N.T.S. 23, 28-29 (1963).

contained the umbrella clause which was worded as: “*Either party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other Party.*”<sup>19</sup> It was noted by a German scholar in the survey of the Pakistan-Germany BIT that such an umbrella clause “*relates particularly to investment contracts between the investor and the host country*” and “*transforms responsibility incurred towards a private investor under a contract into international responsibility.*”<sup>20</sup>

The 1959 Germany-Pakistan BIT went on to lay the foundation for the 1991 German Model BIT which contains an umbrella clause in article 8(2) and has a similar language “*Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party.*”<sup>21</sup> Similarly the US Model BIT of 1983 contains an umbrella clause which was designed with keeping the OECD draft in mind<sup>22</sup> which states that “*each Party shall observe any obligation it may have entered into with regard to investors or nationals or companies of the other Party.*”<sup>23</sup> The US Model BIT was published in 1984 and 1987, subsequently including similarly worded umbrella clauses.<sup>24</sup>

The tribunal on breaking down these umbrella clauses believes that these clauses agree on their effects, namely that such a clause “*raises to a treaty issue any attempt by a BIT partner to invalidate a contract by changes in domestic law or otherwise such that a breach of contract constitutes a breach of treaty.*”<sup>25</sup> Sweeping analyses of BITs assert that umbrella clauses permit the breaches of investor-state contracts to be characterized as BIT violations so as to trigger dispute resolution

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<sup>19</sup>*Id.*

<sup>20</sup>Joachim Karl, *The Promotion and Protection of German Foreign Investment Abroad*, 11 ICSID REV.-FOREIGN INVESTMENT L.J. 1, 23 (1996).

<sup>21</sup>*Id.*

<sup>22</sup>K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on their Origin, Purposes and General Treatment Standards*, 4 INT’L TAX AND BUS. L. 105, 111 (1986).

<sup>23</sup>U.S. Model BIT, 1983, art. II(4).

<sup>24</sup>*Id.*

<sup>25</sup>*Id.* at 23.



procedures provided under the BIT. In a precedent the United Nations Centre on Transnational Corporations noted that an umbrella clause “makes the respect of investor State contracts an obligation under the treaty.

Thus, a breach of such a contract by the host State would engage its responsibility under the [BIT] and—unless direct dispute settlement procedures come into play—entitle the home State to exercise diplomatic protection of the investor.”<sup>26</sup> Likewise the United Nations Conference on Trade and Development (UNCTAD) found in its survey of BITs conducted in the mid-1990s that “*as a result of [an umbrella clause in a BIT], violations of commitments regarding investment by the host country would be redressible through a BIT.*”<sup>27</sup>

Thus the aggregate of the history of umbrella clauses and the virtual body of opinions regarding its interpretation points explicitly to one conclusion: The whole scheme of umbrella clauses applies to responsibilities and obligations arising under investor-state contracts so as to allow for their breach to be resolved as BIT violations.

However to understand umbrella clauses more closely two landmark judgements need to be considered, namely *SGS v. Pakistan*<sup>28</sup> and *SGS v. Philippines*.<sup>29</sup> Both the cases have interpretation of umbrella clauses inconsistent with each other but have the same effect of overturning that conclusion.

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<sup>26</sup>United Nations Centre on Transnational Corporations (UNCTC), *Bilateral Investment Treaties* (New York, United Nations, 1988), Doc No. ST/CTC/65.

<sup>27</sup>*Id.*

<sup>28</sup>*Société Général de Surveillance S. A. v. Islamic Republic of Pakistan*, ICSID (W. Bank) Case No. ARB/01/13 (2003), Objections to Jurisdiction.

<sup>29</sup>*Société Général de Surveillance S. A. v. Philippines*, ICSID (W. Bank) Case No. ARB/02/6 (2004), Objections to Jurisdiction.

#### IV. SCRUTINY OF SUCH CLAUSES IN THE LIGHT OF RIGHTS OF THE STAKEHOLDERS

The enduring consistency of commentators concerning the clause's effect disappeared eventually after the first exhaustive analysis of the clause by the ICSID tribunal in the *SGS v. Pakistan* case.

##### A. *Elevation of Contractual Breaches to International Obligations*

Since the inception of the clause's existence, legal scholars have acknowledged a broader approach in interpretation of the umbrella clauses and the same follows for the majority of tribunals faced with the interpretation of umbrella clauses. Subsequent to the decision in *SGS v. Pakistan* several other tribunals which dealt with the interpretation of the umbrella clause directly addressed the award to contradict its result. Prosper Weil argued in favour of the transformation of mere contractual obligations in his famous Hague lecture in 1969. He stated that:

*“It is so often, that there is no difficulty whatsoever when there is an “umbrella treaty” between the contracting State and the State obligations of the contracting state vis-à-vis the State of the other contracting party. The mere existence of the umbrella treaty turns contractual obligations into international obligations and by the virtue of which ensures, the intangibility of contract under the threat of violating the treaty; any performance of the contract under the threat of violating the treaty, any performance of the contract, even if it is legal under the national law of the contracting of the other contracting party, which turns the obligation to perform the contract into an international State, gives rise to the international liability of the latter vis-à-vis the national State of the other contracting party.”*

In the view of Emmanuel Gaillard in the case of an umbrella clause, the engaged State is internationally responsible for the violation of a contract as a violation of the treaty. He calls this a “mirror effect”<sup>30</sup> of the clause:

*“You have a violation of the contract, and the treaty says as if you had a mirror, that this violation will also be susceptible to being characterized as a violation of the Treaty.”*<sup>31</sup>

Shreuer contends that “*under the operation of an umbrella clause, the claim need not fail if the investor is unable to demonstrate a violation of one of the BIT’s substantive provisions. The often difficult proof that there has been a violation of the ‘fair and equitable treatment’ or ‘full protection and security’ standards or that there has been an ‘indirect expropriation’ is no longer decisive, provided a breach of an investment contract can be shown.*”<sup>32</sup> Hence, “*under the regime of such an umbrella clause, any violation of a contract thus covered becomes a violation of the BIT.*”<sup>33</sup>

#### *B. The narrow interpretation or rejection of an elevating effect*

The significance of a narrow interpretation approach guides to an undemonstrative function of the umbrella clause. The Tribunals in order to dodge the State’s international responsibility for every single breach of contract adopted this approach. These decisions however cannot be rejecting the wide function of the clause in an undivided manner, but these are to be judged in the light of their specific circumstances.

The case of *SGS v. Pakistan* among the decisions of tribunals that adopt a restrictive approach, stands a very important one. This case on the other end of the spectrum, envisages the clearest negation of the clause’s broad

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<sup>30</sup>E. Gaillard, *Investment Treaty Arbitration and Jurisdiction over Contract Claims- The SGS Case considered*, in T. WEILER, *INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW* 325, 344 (2005).

<sup>31</sup>SGS’s response to the objections of Pakistan in *SGS v. Pakistan*, *Supra* note 28.

<sup>32</sup>DOLZER & STEVENS, *Supra* note 2.

<sup>33</sup>SGS’s response to the objections of Pakistan in *SGS v. Pakistan*, *Supra* note 28.

interpretation. It was the first time that an international arbitral tribunal was examining the effects of an umbrella clause exhaustively.<sup>34</sup> Therefore, the tribunal's decision became the bone of contention of the actual debate.

It is important to note here that with the subsequent decision in this case the tribunal placed itself opposite the majority doctrine. With its "outright rejection."<sup>35</sup> it stands aloof from the overwhelming part of traditional interpretations that have been given to the clauses. It is however important to note that the tribunals that seem to follow this approach do so in regard to very specific situations and not in a generally fashioned way.

Commentators in the past have though criticised the far-reaching impact on a state's sovereignty because of the broad interpretation of the clause. After its first appearance, there were doubts whether states that may be most affected by the clause would agree to such a provision. The contention that is made that the mere hope that investors would invoke umbrella clauses with appropriate restraint and not for "trivial disputes"<sup>36</sup> is insufficient to serious jeopardy to the whole system of investment protection through BITs. The narrow approach was followed by two other tribunals.

The case between Joy Mining Machinery Limited and Egypt arose out of contract concerning the provision of specialized long-wall mining equipment for a phosphate mining project.<sup>37</sup> As the abovementioned case was more in form of a commercial dispute rather than an investment within the treaty's notion of investment but a purely commercial dispute, the tribunal concluded that it lacked jurisdiction.

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<sup>34</sup>Prior to the *SGS v. Pakistan* decision, the clause was applied only once in *Fedax N.V. v. Venezuela*, ICSID Case No. ARB/96/3 (1998).

<sup>35</sup>T. Walde, *The "Umbrella" Clause in Investment Arbitration- A Comment on Original Intentions and Recent Cases*, 6 JWIT 183 (2005).

<sup>36</sup>C. Schreuer, *Travelling the BIT Route- of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 JWIT 231 (2004).

<sup>37</sup>*Joy Mining Machinery Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/03/11 (2004).

Despite the fact that the problem at hand did not entail an investment dispute the tribunal went ahead and addressed the meaning of the alleged umbrella clause in article 2(2) of the UK-Egypt BIT.<sup>38</sup>

In this context, the tribunal said that every breach of contract cannot be transformed into a violation of the Treaty, unless there is a direct correlation between the violation of the Treaty rights and the breach of the contract, to trigger the treaty protection.<sup>39</sup>

In sum, the case does not represent an approach as narrow as the one applied in *SGS v. Pakistan*, and do not sustain such an approach in a general manner. The view taken in *SGS v. Pakistan* is that the tribunal has an advantage with regard to the effectiveness of dispute resolution. The non-qualification of many international arbitrators to deal adequately with the domestic law of foreign States argues in favour of the local court's jurisdiction.<sup>40</sup>

## V. INVOCATION OF UMBRELLA CLAUSES AND THE PRINCIPLE OF PRIVACY OF CONTRACT

Now, even if an individual contract is considered to be under the ambit of the umbrella clause, then the tribunal encounters a different issue: whether the clause can be invoked only by the parties to the contract, or whether the ambit of such clauses is wide enough to cover sub-state entities, holding and subsidiary companies or shareholders of the parties to the BIT?

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<sup>38</sup>UK-Egypt BIT, Art 2(2) of the BIT provides that “each contracting party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other contracting parties.”

<sup>39</sup>*Joy Mining Machinery Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/03/11 (2004).

<sup>40</sup>J. Gill et al., *Contractual Claims and Bilateral Investment Treaties- A comparative Review of the SGS Cases*, 21J. INT'L ARB. 31 (2004).

Arbitration is considered to be a creation of existence, i.e., the arbitral decree is binding only on the consenting parties. Nevertheless, investment arbitration has been demarcated as ‘arbitration without privity,’<sup>41</sup> as BITs, though they are executed between States but they frequently deliver a ‘standing offer’ to arbitrate to the investors.<sup>42</sup>

The literature on this matter is limited and so the case laws are also inconsistent on this subject. And, the reason for this inconsistency is the fact that the drafting of such clauses is different in each case.

A. *Ensnoring the investors under the shade of umbrella clauses*

The first concern on umbrella clauses and privity of contract rests on the investor’s side. Recent MITs and BITs permit investors to mark their investments through various ways. Investment is frequently explained as every kind of asset,<sup>43</sup> containing, inter alia, shares in a corporation, contractual rights and intellectual property rights. Most of the investments are made through the acquisition of shares in companies of the host State or by incorporating subsidiaries (e.g. – Special Purpose Vehicle) solely to facilitate the investment. Hence, raising the issue as to whether such clauses can cover the subsidiary or the investor itself, when its investment is basically a share in the domestic company which signed the contract. On this subject-matter, a lucid demarcation in trends can be observed, subject to whether the investor is entitled to claim rights owed to its subsidiary, or to the company wherein it holds shares interest.

a) *Safeguards Provided To Subsidiaries Against The Host State*

In case of subsidiaries, tribunals have not deemed the umbrella clause to cover them. In *Azurix v. Argentina*,<sup>44</sup> the tribunal rejected the claim on merely two grounds: firstly, that the contract was executed with the Province of Buenos Aires, instead of Argentina and lastly, that the second party to the contract was not the claimant (Azurix) itself, but its

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<sup>41</sup>Jan Paulsson, *Arbitration without Privity*, 10 ICSID REV. – FOREIGN INVEST. L.J. 232 (1995).

<sup>42</sup>*Id.*

<sup>43</sup>Ecuador-Netherlands BIT, art. 1(a).

<sup>44</sup>*Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12 (2006).

subsidiary ABA. Likewise, the Siemens tribunal solely rejected the claim on the rationale that the claimant did not execute the contract and SITS, Siemens' subsidiary, was not a party to the arbitral proceedings.<sup>45</sup>

In *Burlington v. Ecuador*, the tribunal made an exhaustive analysis to determine whether the claimants could depend on the umbrella clause to impose its wholly owned subsidiary's rights under a contract executed with Ecuador. The tribunal regarded that the word obligation was the 'operative' phrase of the umbrella clause, and for the purposes of defining it, two fundamentals had to be kept in mind; the fact that someone's obligation involves the rights of another and that obligations occurs under the ambit of a legal framework, usually the domestic law. In pursuance of these legal fundamentals, the majority held that Ecuador's obligations under the contract were allied to the subsidiary of Burlington, and that Ecuadorian law does not affirm the fact that the non-signatory holding company could claim the rights of its subsidiary.<sup>46</sup>

Notably, in the *CMS v. Argentina* nullification verdict,<sup>47</sup> the ad hoc committee nullified the portion of the arbitral award with regard to the Tribunal's verdicts on the umbrella clauses. The committee observed five significant issues with the tribunal's construal of the umbrella clause, which may be difficult for further tribunals to neglect.<sup>48</sup>

The committee was of the opinion that a rational interpretation of the clause should address the forthcoming issues: (i) the phrase any obligations it may have entered into with regard to investments, of the clause, was evidently concerned with consensual obligations ascending out of the BIT; (ii) consensual obligations are generally entered into with respect to specific individuals; and (iii) if the applicable law and content

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<sup>45</sup>Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8 (2007).

<sup>46</sup>Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5 (2012).

<sup>47</sup>CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8 (2007).

<sup>48</sup>El Paso Energy International Company v. Argentine Republic, ICSID Case No. ARB/03/15 (2011), 190-198, 533.

of the liability are not altered by the umbrella clause, then the parties to the obligation should not alter either.<sup>49</sup>

The other grounds stated by the ad hoc committee were: (i) the wide interpretation endows the claimant to administer the contractual rights of its subsidiary despite of the fact that the claimant is not bound to administer its subsidiary's contractual liabilities; and (ii) the construal will render the mechanism in Article 25(2) (b) of the ICSID Convention<sup>50</sup> futile.

The Burlington tribunal and CMS annulment committee undoubtedly established a convention to examine: whether the investor can enforce the breach of a contract executed with the subsidiary company. It established that the domestic law that administers the contract, which generally necessitates privity for the purposes of ascertaining which parties are liable to each other.

*b) Safeguards Provided To Shareholders Against The Host State*

On the contrary, a plethora of tribunals has observed that when the investment is made by virtue of purchasing shares in the host state's country, the investor, as a shareholder may have a right to enforce the breach of obligation with regard to the company in which they have shares, in the case when the value of shares, i.e. investment by the investor, is affected by such breach.

In the matter of CMS and Argentina, the tribunal established that the umbrella clause of the US-Argentina BIT has been breached by Argentina as they had failed to satisfy the contractual obligation executed

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<sup>49</sup>CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8 (2007).

<sup>50</sup>Article 25(2) (b), Convention on The Settlement of Disputes Between States And National of Other States, 1965: This provision states that "any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention."



with the Argentine company- TGN, in which CMS held minority stakes. Albeit its observations were later nullified for not stating proper reasons, it is comprehensible that the tribunal observed grounds to safeguard the rights of an investor that held a minority stakes in a national company, similarly as CMS. The tribunal's rationale was that, in order to find the jurisdiction, it was not necessary for the investor to be a party to the concession agreement with the State as there was an uninterrupted right of action of the shareholders.<sup>51</sup>

In the dispute between EDF and Argentina, the tribunal encountered a similar situation that of Azurix. In this case the investor, who held majority stakes in EDEMSA, a company that executed a contract with the Province of Mendoza. Regrettably, the tribunal was not explicit in enforcing the rights of the investor by virtue of being a shareholder and to claim obligations because of EDEMSA. Nevertheless, it did state that the breach was a governmental act, and that the concession agreement made 'explicit mention of shareholder.'<sup>52</sup>

In *Enron v. Argentina*, similar issues arose, the claimant held minority stakes in TGS, an Argentine company for the distribution and shipping of gas. As a matter of fact, Enron was invited by the Argentine Government to partake in the investment concerning the privatization of TGS.<sup>53</sup> The tribunal also laid emphasis on the fact that Enron's 'technical expertise... was one of the key elements needed to materialize partake in the process' and that, it had assured decision-making power in the management of TGS. Pursuant to these observations, the tribunal held that '*the participation of the Claimants was specifically sought [by the Government] and [...] they are thus included within the consent to arbitration given by the Argentine Republic. . . [Claimants] are beyond*

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<sup>51</sup>CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Objections to Jurisdiction (2003).

<sup>52</sup>EDF International S.A., SAUR International S.A., and León Participaciones Argentinas S.A. v. Argentine Republic, ICSID Case No. ARB/03/23 (2012).

<sup>53</sup>Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Objections to Jurisdiction (2004).

*any doubt the owners of the investment made and their rights are protected under the Treaty.*<sup>54</sup>

According to the tribunal, the invitation by the Argentine Government was conclusive to avow its resolve to have Enron as a foreign investor, and hence, they have the protection under BIT and thus they can resort to the umbrella clause as well as ICSID arbitration. This view is certainly beneficial, as it addresses the rational contemplations of the investor under the principle of fair and equitable treatment. According to this norm, the State parties to a BIT are expected to render international investments such treatment that does not adverse the fundamental expectations, that were taken into consideration by the investor while making the investment.<sup>55</sup>

c) *Rights Of Investors Against Sub-State Entities Under The Operation Of Such Clauses*

In the recent times, investment contracts are entered into with Sub-State entities, when such entities have been delegated by the Government to carry out certain state functions or to deliver any specific service.

The most important case on this issue is *Impregilo v. Pakistan*<sup>56</sup> wherein the claimant executed a contract with the Pakistan Water and Power Development Authority (WAPDA). Though the Italy-Pakistan BIT did not contain an umbrella clause, nonetheless, Impregilo contended that Pakistan had extended such safeguard to other investor under other BITs, and hence, by virtue of Most Favored Nation (MFN) clause embodied in the Italy-Pakistan BIT, Pakistan was obligated to offer protection under the umbrella clause.

However, the tribunal ruled in the favour of Pakistan and held that even if the jurisdiction of umbrella clause is extended to Impregilo by virtue of MFN, then also the clause would not provide any safeguard as the

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<sup>54</sup>*Id.*

<sup>55</sup>*Técnicas Medioambientales TECMED S.A. v. México*, ICSID Case No. AF/00/2 (2003).

<sup>56</sup>*Impregilo SPA v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Objections to Jurisdiction (2005).

investment contracts were executed with WAPDA and not with Pakistan. It further added that ‘in arguendo that Pakistan... has assured the contractual obligations executed with Italian investors (i.e. umbrella clause), but such assurances would not extend to current agreements as Pakistan has not executed them.’<sup>57</sup>

The tribunal also laid emphasis on the status of WAPDA under the domestic law of Pakistan and observed that the ‘status and authority of WAPDA for the purposes of the Agreements, WAPDA is a separate legal entity from the State of Pakistan.’<sup>58</sup>

In the dispute between *Azurix v. Argentina*, the matter was regarding the breach of an investment agreement with the Province of Buenos Aires instead of an Argentine instrumentality. Furthermore, the other party to the contract was not the claimant but its subsidiary, ABA. The tribunal ruled in the favor of Argentina and refused the claim because, ‘Azurix can only claim for breaches, under the BIT, by Argentina, and it owes not obligation to Azurix that has to be honored other than that of BIT.’<sup>59</sup> Thus, Azurix can claim only those rights that are mentioned in the US-Argentina BIT, and not in the contract, which was executed with Province of Buenos Aires.

d) *Progressive interpretation of the clause attributing actions of the sub-state entities to the State*

On the contrary, some tribunals have rendered protection to investors under umbrella clause against sub-state entities. In the matter *Eureko v. Poland*,<sup>60</sup> the claimant had executed an agreement with the State Treasury, who failed fulfil its obligations under the contract. The tribunal deemed the State Treasury as the wing of the Government of Poland, and ruled that every ‘Government of Poland, through its actions and

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<sup>57</sup>*Id.*

<sup>58</sup>*Id.*

<sup>59</sup>*Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12 (2006).

<sup>60</sup>*Eureko B.V. v. Republic of Poland*, IIC 98 (2005).

inactions, has failed to breached its obligations under the Treaty and they have also failed to fulfil its commitment under umbrella clause of the Treaty.’<sup>61</sup>

The leading case on this issue is *SGS v. Pakistan*, wherein the tribunal ruled that according to the principles of State responsibility under the international law, ‘the “commitments”, which are in dispute, mentioned in umbrella clause may be interpreted as commitments of the State itself as a legal person, or of any office, entity or subdivision (local government units) or legal representative thereof whose acts are . . . attributable to the State itself.’<sup>62</sup>

In furtherance of this the International Law Commission (ILC)<sup>63</sup> has codified the International Law Rules on State Responsibility, which contains three articles pertinent to State liability for the conduct of other entities: (i) Article 4 prescribes that the entities which are satisfactorily connected to the State, thus it will be liable for their actions;<sup>64</sup> (ii) Article 5 elucidates those entities which are not satisfactorily connected to the State in order to qualify under Article 4, however, such entities are bestowed with certain governmental authority and State will be held liable for such entities and their actions while exercising that authority;<sup>65</sup> and (iii) Article 8 prescribes entities not satisfactorily connected to the State in order to qualify under Article 4 or 5, but whose certain conducts are attributable to the State to the scope that they are administrated, directed or instructed by the State.<sup>66</sup>

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<sup>61</sup> *Id.*

<sup>62</sup> *Société Général de Surveillance S. A. v. Islamic Republic of Pakistan*, ICSID (W. Bank) Case No. ARB/01/13 (2003), Objections to Jurisdiction.

<sup>63</sup> The ILC is the organ of United Nations which is charged with codifying international law.

<sup>64</sup> International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1, art 4.

<sup>65</sup> International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1, art 5.

<sup>66</sup> International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1, art 8.

In furtherance of these principles the tribunal in *Noble Ventures v. Romania* observed that the obligations assumed by two sub-state entities were also the obligations of the State. The tribunal reached this conclusion by emphasising the fact that both entities were bestowed with the responsibility of representing the State in the privatization process and to enter into the agreements for that purpose. Hence, the tribunal held that the respective privatization agreements were entered on behalf of the State and thus are attributable to the State for the purposes of umbrella clause.<sup>67</sup>

e) *Decisive factors for the obligations of the sub-state entities attributable to the state*

Now, we will have to address the issue whether the obligations assumed by sub-state entities are in fact attributable to State. The ILC rules on State responsibility are supportive but not binding while addressing this issue. Furthermore, the domestic law of the host nation governing the sub-state entity is crucial as it will help in outlining the ambit of the entity's authority. This rationale was used by the tribunals in *Azurix* and *Impregilo*.

On the contrary, the tribunals in *Noble Ventures*, *SGS* and *Eureko* took the help of the principles of public international law, specifically the ILC rules on state responsibility. This approach raises another question: whether the State renounced its sovereign immunity in a way that the tribunal can adjudicate, without referring to the municipal law, if the entity had the authority to enter into an agreement with the investor? Since, this waiver of the sovereign immunity by the State under the BIT will lead to let the arbitrators decide whether the treaty obligations have been breached by the State or not.

Hence, whenever the issue arises as to whether the breach committed by the sub-state entity, under the umbrella clause, is attributable to the State, then the arbitrators will have to resort to the municipal law, including the

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<sup>67</sup>*Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award (2005).

Constitution, of the host State. The tribunal can rely on the ILC rules only when the status and power of the instrumentality is either ambiguous or absent in the municipal law.

This issue has been addressed in the ICSID Convention, wherein Article 25(1) and 25(3) provide the contracting states the option to assign which of its instrumentalities or entities have also agreed to the jurisdiction of ICSID<sup>68</sup> without State's prior approval. This means that the investor can initiate arbitration proceedings against the host State's instrumentality if such designation has been made.<sup>69</sup>

## VI. CONCLUSION

It is well established that umbrella clauses, if interpreted correctly, can be a powerful tool for investors. The clause is multifaceted and allows investor states to bring not only investor-state arbitration proceedings, but also parties alien to their claim against the State, given that party being a shareholder, State instrumentalities or their subsidiaries.

As it can be seen from the reasoning of case laws that it is still immature a time in this area for tribunals to come to a common understanding over the interpretation and application of the umbrella clause, this is, howsoever, because States are at liberty to define the scope of their Treaty and the terms therein. Still, contradictory decisions can be seen with identical umbrella clauses. This unpredictability is probably the current reason for this still being a grey area in the domain of International Investment Arbitration.

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<sup>68</sup>Art 25(3), Convention on The Settlement of Disputes Between States and National of Other States, 1965: This provision states that "Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required."

<sup>69</sup>NIKO Resources (Bangladesh) Ltd. v. People's Republic of Bangladesh, BAPEX and PETROBANGLA, ICISD Case No. ARB/10/11 & ARB/10/18, Objections to Jurisdiction (2013), in which the Tribunal held that the designation provided in Article 25(3) of the ICSID Convention could even be done implicitly.

It doesn't escape the eye in matters of investment arbitration carrying excessive importance for establishing a jurisdiction of an arbitral tribunal that there is no homogenous stand either in jurisprudence or in doctrine. Especially the divergence in ICSID jurisprudence, is matter of great concern.

It should be a thing of general consciousness, however, the paucity of formal stare decisis doctrine in ICSID arbitration seems to be an impediment to ever achieving a complete unified approach. Breaches of a Bilateral Investment Treaty and breaches of a contract should firstly, be kept distinct to a level as to prevent uncertainty and to prevent an overflow of litigation. The Tribunal should be quick enough to resolve a distinction between these two, in an attempt to obtain BIT Jurisdiction.

Secondly, an attempt should be made from states to widen their consent to investment arbitration in all situations they want, but it should be mentioned in the BIT as unambiguously as possible. Thirdly, as it can be seen it is difficult rather impossible to have a uniform interpretation of umbrella clauses, as the wording differs from one BIT to another and each umbrella clause necessarily deserves its own interpretation. The tribunal should decline in seemingly irresolvable cases where there is a doubt as to whether the clause grants jurisdiction to deal with contractual breaches as it is important for keeping the balance of the investment law system.

It is realized that it is rather difficult to achieve the observance of these guidelines in practice but it is something which is desirable and should be aimed for. In conclusion it is in our opinion that the abovementioned guidelines if nothing, would promote more predictability in various issues coming in front of different investment arbitration tribunals. And such predictability would help in facilitating in the protection of both economic and legal interests of host states and investors.