

Chapter 2

Interpretation of the Umbrella Clause in Investment Agreements*

Umbrella clauses have become a regular feature of international investment agreements and have been included to provide additional protection to investors by covering the contractual obligations in investment agreements between host countries and foreign investors. The meaning of the umbrella clauses is one of the most controversial issues with which international arbitral tribunals have been recently confronted with while adjudicating investment disputes brought before them. Through a wide review of the specific textual provisions included in investment agreements, the survey seeks to serve as guidance for negotiators by clarifying the implications deriving from the choice of different drafting options. The paper further examines the interpretation of the clause given by arbitral tribunals on a case-by-case basis. Caution is recommended in trying to draw any conclusions on the interpretation of the clause since the jurisprudence in this field is constantly evolving.

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Introduction

An increasing number of investment treaty arbitrations involve not only the treaties themselves but also investor-state contracts.

The extent of subject matter (*rationae materiae*) jurisdiction is not uniform under Bilateral Investment Treaties (BITs). Some BITs cover only disputes relating to an “obligation under this agreement”, i.e. only for claims of BIT violations. Others extend the jurisdiction to “any dispute relating to investments”. Some others create an international law obligation that a host state shall, for example, “observe any obligation it may have entered to”; “constantly guarantee the observance of the commitments it has entered into”; “observe any obligation it has assumed”, and other formulations, in respect to investments. These provisions are commonly called “umbrella clauses”, although other formulations have also been used: “mirror effect”, “elevator”, “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.

Although the “umbrella clause” has been known since the 1950s and its effects have been discussed in literature and doctrine, it was not until the recent two *SGS Société Générale de Surveillance SA* cases where it started to be tested.¹ Given the very frequent occurrence of the umbrella clause in modern investment treaties, and the different language used in these treaties, it would be useful to examine further the meaning of this clause in particular by taking stock of the specific language included in a number of BITs. The aim of this examination is to improve an understanding of the interpretations of this clause and assist treaty negotiators and parties in taking informed decisions.

For a better understanding of the clause, the present paper first gives a brief overview of its history and its place in the literature and doctrine. Second, it takes stock of the specific language included in a number of BITs, using those of Switzerland, Germany, Denmark, Japan and the United States

1. As Thomas Wälde notes: “The question of whether an international arbitration tribunal had jurisdiction over contractual counter-claims was never fully examined, nor was the question of whether contractual jurisdiction clauses should oust – or precede – the jurisdiction of treaty-based tribunals” in “The Umbrella Clause in Investment Arbitration – A Comment on Original Intentions and Recent Cases”, *The Journal of World Investment and Trade*, Vol. 6 No. 2, April 2005, Geneva.

as representative examples of the different types. Third, it looks at the interpretation given to the clause by arbitral tribunals.

I. History of the clause and literature

A. History of the clause and state practice

The first occurrence of the “umbrella clause”² as a distinct investment protection clause can be traced to the **1956-59 Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries** (the Abs draft) (article 4):³

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

This approach was reformulated in the **1959 Abs-Shawcross Draft Convention on Foreign Investment** (Article II):⁴

*“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.”*

The clause appeared right afterwards in the first **BIT between Germany and Pakistan** 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.”*

The clause was also one of the core substantive rules of the **1967 OECD draft Convention on the Protection of Foreign Property** (Article 2)⁵ which provided that:

2. For a complete history of the umbrella clause see A.C. Sinclair: “The Origins of the Umbrella Clause in the International Law of Investment Protection”, *Arbitration International* 2004, Vol. 20, No. 4, pp. 411-434. Sinclair’s research suggests that the origins can be traced to the advice provided by Sir Elihu Lauterpracht in 1953-54 to the Anglo-Iranian Oil Company in connection with the settlement of the Iranian oil nationalisation dispute. The so-called “umbrella” or “parallel protection” treaty was again proposed in Lauterpracht’s advice given in 1956-57 to a group of oil companies contemplating a trunk pipeline from Iraq in the Persian Gulf through Syria and Turkey to the Eastern Mediterranean.
3. See H.J. Abs “Proposals for Improving the Protection of Private Foreign Investments”, In *Institut International d’Études Bancaires*, Rotterdam, 1958 as cited by A. Sinclair, *op. cit.*, note 2.
4. The text of the Abs-Shawcross Draft is reprinted in UNCTAD International Investment Instruments: A Compendium in *United Nations*, New York, 2000, Vol. V. p. 395.
5. “Draft Convention on the protection of foreign property and Resolution of the Council of the OECD on the Draft Convention”, *OECD Publication No. 23081*, November 1967.

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

The Notes and Commentaries accompanying the draft Convention describe this article as an application of the general principle of *pacta sunt servanda* in favour of the property of nationals of another party, and their lawful successors in title unless the undertaking expressly excludes such succession. According to the Commentaries, property included but is not limited to investments which are defined in Article 9 as all property, rights and interests whether held directly or indirectly, including the interest which a member of a company is deemed to have in the property of the company. Property is to be understood in the widest sense.⁶ However, the commentary limits the scope of Article 2 by insisting that undertakings must relate to the property concerned; it is not sufficient if the link is incidental.⁷

The **draft MAI** text provided – in the Annex, listing negotiating proposals, two formulations for a “respect clause”:

Respect Clause: “Each Contracting Party shall observe any obligation it has entered into with regard to a specific investment of an investor of another Contracting Party” and,

Substantive approach to the respect clause: “Each contacting Party shall observe any other obligation in writing, it has assumed with regard to investments in its territory by investors of another Contracting Party. Disputes arising from such obligations shall only be settled under the terms of the contracts underlying the obligations.”

The **Energy Charter Treaty**⁸ in the final sentence of Article 10(1) requires that:

“Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”⁹

This is however accompanied by a derogation provision included in the Annex IA. This provision allows the contracting parties to opt out of the final sentence of Article 10(1) by not permitting their investors to submit a dispute concerning this provision to international arbitration. Four ECT contracting

6. For a detailed analysis of this provision and the Notes and Commentaries as well as related reactions by scholars, see A. Sinclair, *op. cit.*, note 2, pp. 427-433.

7. Notes and Comments to Article 2, para. 3(a), *op. cit.*, note 5.

8. The Energy Charter Treaty was signed on 17 December 1994, available at www.encharter.org.

9. The accompanying Secretariat document defines the scope of the provision as follows: “Article 10(1) has the important effect that a breach of an individual investment contract by the host state country becomes a violation of the ECT. As a result, a foreign investor and its home country may invoke the dispute settlement mechanism of the Treaty”, The Energy Charter Treaty: A Reader’s Guide, June 2002, p. 26.

parties have chosen to apply this derogation: Australia, Canada, Hungary and Norway.

It is estimated that, of the 2 500 or more **BITs** currently in existence approximately forty per cent contain an umbrella clause.¹⁰ Treaty practice of States does not point to a uniform approach to the treatment of these clauses. While Switzerland, the Netherlands, the United Kingdom and Germany,^{11, 12} often include umbrella clauses in their BITs, France, Australia and Japan include umbrella clauses in only a minority of their BITs. Of 35 French BITs examined, only 4 contain an umbrella clause¹³ while only 5 out of 20 Australian BITs¹⁴ and 2 of the 9 Japanese BITs examined.¹⁵ Canada is the only OECD member state examined in this study which has never included an umbrella clause in its BITs.¹⁶ Treaty practice of the United States has changed with the new model BIT; while 34 of the 41 US BITs examined, based on the former Model, contained an umbrella clause, its presentation is very different in the 2004 US Model BIT.

B. Literature

The understanding of commentators and drafters on the umbrella clause provision at the time of the draft OECD Convention was that while the clause probably did cover international obligations, its focus was contractual obligations accepted by the host state with regard to foreign property.¹⁷

Commenting on the same provision, **Brower**,¹⁸ raised the possibility that the article's scope *rationae materiae* may have been limited so as only "to apply

10. Figure cited in Gill, Gearing and Birt, *Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases* (2004) 21:5 J. Int. Arb. 397 at footnote 31.

11. Article 10 Swiss Model BIT, Article 3(4) Netherlands Model BIT, Article 2(2) UK Model BIT and Article 8 Germany Model BIT 1991(2).

12. Of 66 Swiss BITs examined, 48 contain an umbrella clause; of 89 UK BITs examined 87 contain an umbrella clause; of 86 Dutch BITs examined 76 contained an umbrella clause; of 71 German BITs examined 68 contain an umbrella clause.

13. Article 3 France-Hong Kong BIT 1995; Article 2 France-Peru BIT 1993; Article 8 France-Russia BIT 1989; Article 2(2) France-Yemen BIT 1984.

14. Article 11 Australia-Chile BIT 1996; Article 11 Australia-China BIT 1988; Article 2(2) Australia-Hong Kong BIT 1993; Article 11 Australia-Papua New Guinea BIT 1990; Article 10 Australia-Poland BIT 1991.

15. Article 2(3) Japan-Hong Kong BIT 1997; Article 3(3) Japan-Russia BIT 1998.

16. 23 Canadian BITs were examined in this study; the BITs not examined are those concluded with Bangladesh (1990) and Slovakia (2001).

17. See Sinclair, *op. cit.*, note 2.

18. C.N. Brower, "The Future of Foreign Investment-Recent Developments in the International Law of Expropriation and Compensation" in V.S. Cameron (eds.), *Private Investors Abroad – Problems and Solutions in International Business in 1975* (Southwestern Legal Foundation Symposium Series, Private Investors Abroad, Matthew Bender, New York, 1976), pp. 93, 105, note 27, as cited by A. Sinclair, *op. cit.*, note 2.

Box 2.1. The discussions during the MAI negotiations

The MAI Drafting Group considered the question of provisions which might be included in the MAI on investor rights arising from other agreements. Three broad conceptual approaches emerged. These were, in ascending order of ambition: i) a “zero” option, i.e., no special provision in the MAI on rights under investor-state agreements; ii) a procedural provision, i.e., a dispute settlement clause; or iii) a substantive and procedural provision, i.e., a “respect clause”. The third approach was considered the most ambitious. It would make respect for such investor-state agreements into a MAI obligation, giving them substantive protection of the international law rule, *pacta sunt servanda*. Arguably, this could affect the defences of or damages owed by a government asserting rights to cancel or modify a contract for sovereign reasons or to change laws affecting an investment. It also has the following essential procedural effect: violations of the investor-state agreement would be subject to the full range of MAI dispute settlement mechanisms, including state-state consultations and arbitration. In such settlement, the issues would be considered in a broad context including both domestic and international law.

The MAI Drafting Group considered that: “the second and third approaches would, in effect, amend investor-state agreements. They could introduce uncertainties about the law and remedies to be applied in case of dispute. They raise the questions of whether and how to draw a line between the kinds of agreements for which the additional protection might be appropriate and those for which it might not, such as purely commercial bargains, or agreements settling tax or other administrative claims.”

There was no consensus in the Group on the basic choice of approach. That choice might have also been affected by outcome on a provision stating that the more favourable of the MAI or those investor-state agreements prevailed. If a decision were taken to pursue either the second (procedural) or third (substantive and procedural) approach, there would be subsidiary questions, the most important being scope of coverage. Should the provision apply broadly to all investor rights under investor-state agreements? If not, should it be limited by, for example, distinguishing between rights arising under essentially commercial agreements (presumably excluded) and those under which a state is acting as a sovereign (presumably covered) – a distinction which may be difficult to make in practice; or enumerating or defining categories of covered rights, such as those arising out of investment agreements and authorisations on which an investor has relied.

The Group examined the strategic choices and issues thoroughly, in the time available, and clarified their implications. Given the range of views, the Group did not elaborate draft provisions for inclusion in the MAI. However, it agreed to provide the above mentioned provisions to aid in understanding the basic choices. These texts were not examined by the Group and did not represent specific recommendations. See “Report of The Drafting Group Concerning the Protection of Investor Rights Arising from Other Agreements”, DAF/MAI/DG1(96)REV1, 18 March 1996, in www1.oecd.org/daf/mai/pdf/dg1/dg1961r1e.pdf.

specifically to large-scale investment and concession contracts – in the making of which the state is deliberately ‘exercising its sovereignty’ – and thus it might be argued that the ordinary commercial contracts are an implied exception to the general rule set forth in Article 2”.¹⁹

Today, it seems that a more consistent view emerges among commentators on the scope of the umbrella clause. In his Hague lecture, **Prosper Weil** presented the idea that an investment treaty would transform a mere contractual obligation between state and investor into an international law obligation, in particular if the treaty included a clause obliging the state to respect such contract.²⁰

F. Mann also was of the view that the umbrella clause in the BITS protects the investor against a mere breach of contract: “This is a provision of particular importance in that it protects the investor against any interference with his contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of the question whether or not such interference amounts to expropriation. The variation of the terms of a contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for instance, by non-payment, the dissolution of the local company with which the investor may have contracted and the transfer of its assets (with or without the liabilities) – these and similar acts the treaties render wrongful.”²¹

I. Shihata, former Secretary-General of ICSID, also recognised that “treaties may furthermore elevate contractual undertakings into international law obligations, by stipulating that breach by one State of a contract with a

19. Wälde notes that contracts related to investment – at this time seen in a much more narrow way as “foreign direct investment” than today – did by their very nature always involve a governmental dimension. Treaties at this time also only provided for state-to-state arbitration which was a screening mechanism against exorbitant and gratuitous use of treaties by private commercial operators. “The ‘Umbrella’ (or Sanctity of Contract/Pacta Sunt Servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases”, *Transnational Dispute Management*, Vol. 1, Issue #04, October 2004.

20. “Il n’y a, en effet, pas de difficultés particulières [en ce qui concerne la mise en jeu de la responsabilité contractuelle de l’État] lorsqu’il existe entre l’État contractant et l’État national du cocontractant un traité de « couverture » qui fait de l’obligation d’exécuter le contrat une obligation internationale à la charge de l’État contractant envers l’État national du cocontractant. L’intervention du traité de couverture transforme les obligations contractuelles en obligations internationales et assure ainsi, comme on l’a dit, « l’intangibilité du contrat sous peine de violer le traité » ; toute inexécution du contrat, serait-elle même régulière au regard du droit interne de l’État contractant, engage dès lors la responsabilité internationale de ce dernier envers l’État national du cocontractant”. *Recueil des Cours III*, 1969, pp. 132 et seq.

21. F.A. Mann “British Treaties for the Promotion and Protection of Investments”, *52 British Yearbook of International Law* 241 (1981), p 246.

private party from the other State will also constitute a breach of the treaty between the two States”.²²

Dolzer and Stevens along the same lines state that: “These provisions seek to ensure that each Party to the treaty will respect specific undertakings towards nationals of the other Party. The provision is of particular importance because it protects the investor’s contractual rights against any interference which might be caused by either a simple breach of contract or by administrative or legislative acts and because it is not entirely clear under general international law whether such measures constitute breaches of an international obligation.”²³

E. Gaillard notes that an historical examination of the origins of observance of undertakings clauses – “clauses with a mirror effect” – shows “in the clearest manner” that the intention of States negotiating and drafting such clauses is to permit a breach of contract to be effectively characterised as the breach of an international treaty obligation by the host state. The effect of the clause is to reflect at the level of international law what is analysed at the level of applicable private law as simple contractual violation.²⁴

C. Schreuer states that “umbrella clauses have been added to some BITs to provide additional protection to investors beyond the traditional international standards. They are often referred to as ‘umbrella clauses’ because they put contractual commitments under the BIT’s protective umbrella. They add the compliance with investment contracts, or other undertakings of the host State, to the BIT’s substantive standards. In this way, a violation of such a contract becomes a violation of the BIT”.²⁵

UNCTAD’s²⁶ analysis of the provision is less categorical. It notes that “the language of the provision is so broad that it could be interpreted to cover all kinds of obligations, explicit or implied, contractual or non-contractual, undertaken with respect to investment generally. A provision of this kind might possibly alter the legal regime and make the agreement subject to the rules of international law”.

A middle approach is expressed by **T. Wälde**. He believes that the principles of international law would only protect breaches and interference

22. I. Shihata, “Applicable Law in International Arbitration: Specific Aspects in Case of the Involvement of State Parties”, in I.F.I. Shihata and J.D. Wolfensohn (eds.), *The World Bank in a Changing World: Selected Essays and Lectures*, Vol. II, Brill Academic Publishers, Leiden, Netherlands, 1995, p. 601.

23. R. Dolzer and M. Stevens “Bilateral Investment Treaties”, *Kluwer Law*, 1995, pp. 81-82.

24. E. Gaillard, “L’arbitrage sur le fondement des traités de protection des investissements”, *Revue de l’Arbitrage*, p. 868, note 43.

25. C. Schreuer, “Travelling the BIT Route: of Waiting Periods, Umbrella clauses and Forks in The Road”, *J. World Inv.* (2004) pp. 231-256.

26. “Bilateral Investment Treaties in the mid-1990s”, United Nations, 1998, p. 56.

with contracts made with government or subject to government powers, if the government exercised its particular sovereign prerogatives to escape from its contractual commitments or to interfere in a substantial way with such commitments. This would apply as well to contracts concluded only with private parties in the host state if such contracts are destroyed by government powers. “[...] If the core or centre of gravity of a dispute is not about the exercise of governmental powers [...] but about ‘normal’ contract disputes, then the BIT and the umbrella clause has no role.”²⁷

A different view is expressed by **P. Mayer**, who maintains that the nature of the *inter pares* relationship remains unchanged and is subject to the *lex contractus* and that only the interstate relationship is subject to international law.²⁸

II. Significance of the language of the umbrella clause in treaties

A comparative analysis of the umbrella clauses reveals some common features but also a certain disparity in language use which leads to the question of the scope and effect of each particular clause (Annex 2.A1). Arbitral jurisprudence and doctrine demands each clause to be interpreted on its own terms; as such, the specific wording of an umbrella clause is crucial to its scope and effect. More specifically, these questions relate to i) whether the placement of the clause has any effect on the interpretation of umbrella clauses; ii) what obligations or commitments are protected under umbrella clauses and iii) which investors and/or investments can benefit from the protection of an umbrella clause.

Common features of a general nature

As a general proposition, a common factor between umbrella clauses is the use of *mandatory language*. For example, Article 8(2) of the German Model BIT 1991(2) reads:

“Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party”.

A different formulation is found in Article 10 of the Australia-Poland BIT 1991 which is phrased in less forceful terms:

“A Contracting Party shall, subject to its law, do all in its power to ensure that a written undertaking given by a competent authority to a national of the other Contracting Party with regard to an investment is respected”.

27. T. Wälde, *op. cit.*, notes 1 and 19.

28. P. Mayer, “La neutralisation du pouvoir normatif de l’État en matière de contrats d’État”, *JDI*, 1986, pp. 36-37.

A second feature common to the majority of BITs examined is that they relate to obligations undertaken by the State and do not refer to obligations between private individuals. The Czech Republic-Singapore BIT 1995 however, provides a noteworthy exception to this general proposition by providing that it is also incumbent on the State not to interfere with contracts relating to the investment entered into between private parties. Article 15 reads:

“(2) Each Contracting Party shall observe commitments, additional to those specified in this Agreement it has entered into with respect to investments of the investors of the other Contracting Party. Each Contracting Party shall not interfere with any commitments, additional to those specified in this Agreement, entered into by nationals or companies with the nationals or companies of the other Contracting Party as regards their investments”.

Structure of the Bilateral Investment Treaty

The placement of the umbrella clause within the framework of the bilateral investment treaty is a point of variance in treaty practice. The Netherlands Model BIT²⁹ places the umbrella clause within an article detailing the substantive protections provided under the Treaty. This structure can also be seen in a number of BITs including those concluded by the United Kingdom, New Zealand, Japan, Sweden and the US. By contrast, the Swiss Model BIT places the umbrella clause in a provision entitled “other commitments” and separates it from the substantive provisions by two dispute resolution clauses and a subrogation clause. The majority of BITs concluded by Switzerland follow this format; a notable exception however, is the Switzerland-Kuwait BIT 1998 which places the umbrella clause in Article 3 on protection of investments. The Swiss Model BIT format is also found in the Finnish and Greek Model BITs and BITs concluded by Mexico.³⁰ A third variant is to place the umbrella clause in a separate provision from the substantive protections but before the dispute resolution clauses. This structure can be seen in the German Model BITs which place the umbrella clause in Article 8.

The effect of the placement of the umbrella clause within the overall framework of the BIT is uncertain. The Tribunal in *SGS v. Pakistan* (see below) was of the opinion that the placement of the clause near the end of the Swiss-Pakistan BIT, in the same manner as the Swiss Model BIT, was indicative of an intention on the part of the Contracting Parties not to provide a substantive obligation. The Tribunal considered that had the Contracting Parties intended to

29. Article 3 Netherlands Model BIT; but see the Netherlands-Malaysia BIT 1971 and the Netherlands-Senegal BIT 1971 which place the umbrella clause in Articles 14 and 8, respectively.

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

create a substantive obligation through the umbrella clause it would logically have been placed alongside the other so-called “first order” obligations. By contrast, the *SGS v. Philippines* Tribunal opined that while the placement of the clause may be “entitled to some weight”, it did not consider this factor as decisive. In this respect, the Tribunal stated “it is difficult to accept that the same language in other Philippines BITs is legally operative, but that it is legally inoperative in the Swiss-Philippines BIT merely because of its location”.³¹

Scope and effect

A crucial issue in respect of umbrella clauses is the scope and nature of the obligations undertaken. Textual differences can be seen between umbrella clauses that refer to “commitments”,³² “any obligation”³³ and “any other obligation”.³⁴ Importantly, the phrase “any obligation” was given greater elucidation in the Partial Award rendered in *Eureko v. Poland*; the Tribunal stated: “‘Any’ obligations is capacious; it means not only obligations of a certain type, but ‘any’ – that is to say, all – obligations.”³⁵

While some umbrella clauses refer to obligations “entered into”³⁶ by a State, others refer to obligations “assumed”³⁷ by the State. The Finnish Model BIT refers to obligations which the State may “have” with regard to a specific investment.³⁸ These variations raise the question whether the obligation referred to is a contractual obligation between the State and the investor or whether it could extend to unilateral obligations undertaken by the State through, *inter alia*, promises, legislative acts or administrative measures. It has been suggested that the words “obligations entered into” may be interpreted as confining the obligations in question to those undertaken *vis-à-vis* the other Contracting Party.³⁹ On the other hand, the Tribunal in *SGS v. Pakistan* found the language “commitments entered into” broad enough to encompass unilateral obligations, including municipal acts and administrative measures.⁴⁰

While in most of the BITs which contain an umbrella clause the language is clear and straightforward: “shall observe” or “shall respect”, in some others it is more ambiguous and may leave room for different interpretations. This is the

31. *Ibid.*, note 2, para. 124.

32. Article 7(2), Belgium and Luxembourg-Saudi Arabia BIT 2002.

33. Article 11(2), Greek Model BIT 2001.

34. Article 2(3), Greece-Argentina BIT 1999 [not in force].

35. *Eureko B.V. v. Poland*, Partial Award 19, August 2005, para. 246.

36. UK Model BIT Article 2, Promotion and protection of investment.

37. UK-Lebanon BIT 1999, Article 10, Other obligations.

38. Article 12, Application of other rules Finland Model BIT.

39. W. Ben Hamida, *La clause relative au respect des engagements dans les traités d’investissement*, Institut des Hautes Études Internationales, 21 May 2005 and arguments of the Parties in *SGS v. Pakistan*, *ibid.*, note 1.

40. *SGS v. Pakistan*, at 163-166.

case for instance of the Switzerland-Pakistan BIT (the basis for the *SGS v. Pakistan* case) where either contracting Party “shall constantly guarantee the observance of the commitments”; the Italy-Jordan BIT (the basis for the *Salini v. Jordan* case) “each contracting Party shall maintain in its territory a legal framework apt to guarantee to investors the continuity of legal treatment, including the compliance, in good faith of all undertakings assumed with regards to each specific investor”.

Certain BITs provide greater specificity as to their scope of application by identifying more precisely the types of obligations covered by the clause. Australian BITs concluded with Chile, China, Papua New Guinea and Poland all refer to “written obligations”.⁴¹ In a similar vein Article 2 of the Austria-Chile BIT 1997 refers to “contractual obligations”. The majority of BITs concluded by Mexico that contain an umbrella clause appear to qualify its scope of application, stating that “disputes arising from such obligations shall be settled under the terms of the contract underlying the obligation”.⁴² A number of Mexican BITs also make explicit reference to “written obligations”,⁴³ in contrast, both the Mexico-Netherlands⁴⁴ and Mexico-Switzerland BITs are phrased in broader terms. Article 10 of the latter BIT provides:

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

A further distinction between various BITs is the degree to which the object of the obligations is specified. An example of a broadly phrased umbrella clause is in the 1983, 1984 and 1987 US Model BITs,⁴⁵ as found in Article 2(2)(c) of the US-Argentina BIT 1991, for instance, which states: “Each Party shall observe any obligation it may have entered into with regard to investments”, and in many UK BITs as well, including its first with Egypt in 1975: “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.”

This can be contrasted to Article 9 of the Austrian Model BIT which provides “Each Contracting Party shall observe any obligation it may have entered into with regard to specific investments by investors of the other Contracting Party”.

41. Article 11, Australia-Chile BIT 1996; Article 11, Australia-China BIT 1988; Article 11, Australia-Papua New Guinea BIT 1990; and Article 10, Australia-Poland BIT 1991.

42. Article 9, Austria-Mexico BIT 1998.

43. Article 9, Mexico-Austria BIT 1998; Article 9, Mexico-Belgium and Luxembourg BIT 1998; Article 8(2), Mexico-Germany BIT 1998 [not in force]; Article 19, Mexico-Greece BIT 2000; Article 10, Mexico-France BIT 1998.

44. Article 3(4), Mexico-Netherlands BIT 1998 “Each Contracting Party shall observe any other obligation it may have entered into with regard to investments in its territory by nationals of the other Contracting Party [...]”

45. US-Senegal BIT, US-Panama, US-Zaire BITs. See R.S. Gudgeon, “United States Bilateral Investment Treaties: Comments on their Origin, Purposes, and General Treatment Standards” in 11 *Int’l Tax and Bus. L.* 105 at 111 (1986).

Similar language is included in the Swiss-Philippines BIT (basis for the *SGS v. Philippines* arbitration).

Example 1: Treaty Practice of Switzerland

Even within the Treaty practice of a single state, it is difficult to find uniformity in use of umbrella clauses. As noted above, the Swiss Model BIT separates the umbrella clause from the other substantive provisions, placing it near the end of the Treaty after the dispute resolution and subrogation clauses. Its Article 10(2) reads:

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

Of the 66 Swiss BITs examined, 12 contained no umbrella clause while 22 followed the text and format of the Model BIT. A notable departure from this Model can be seen in the Switzerland-Kuwait BIT 1998 which places the umbrella clause in Article 3 on Protection of investments. Article 11 of the Switzerland-Pakistan BIT (the basis for the *SGS v. Pakistan* case) uses a different language:

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

All the above clauses can be contrasted to Article 13 of Switzerland-India BIT 1997 which provides:

“Each Contracting Party shall observe any obligation it may have entered into with regard to an investment of an investor of the other Contracting Party. In relation to such obligations dispute resolution under Article 9 of this Agreement shall however only be applicable in the absence of normal local judicial remedies being available.”⁴⁶

Example 2: Treaty Practice of Denmark

A small difference in language is apparent between the Danish Model BIT and the Denmark-Korea BIT 1988. Article 3 on the Promotion and protection of investment of the Model BIT reads:

“Each Contracting Party shall observe any obligation it may have entered into with regard to investment of investors of the other Contracting Party”.

The Denmark-Korea BIT, on the other hand, in its Article 3 on Protection of investment provides:

“[...] 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”.

46. For similar language in an umbrella clause see also the Germany-India BIT 1995.

In sharp contrast to these two provisions is the Denmark-China BIT 1985 Article 3 on Protection of Investment which provides:

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

In a similar vein, the Denmark-Kuwait BIT 2001 refers to obligations entered into with regard to “any particular investment of an investor” while the Denmark-India BIT 1995 closely follows the Model BIT but adds “with disputes arising from such obligations being only redressed under the terms of the contracts underlying the obligations”.

Example 3: Treaty Practice of Germany

The German Model BIT⁴⁷ places the umbrella clause in a separate Article 8 and reads:

*“Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party⁴⁸/investments in its territory by investors of the other Contracting State”.*⁴⁹

Of 71 German BITs examined, 3 contained no umbrella clause and 16 paralleled the Model BITs. The Germany-Bangladesh BIT 1981 provides greater specificity by providing in Article 7(2):

*“Each Contracting Party shall observe any other obligation it may have entered into with regard to investments in its territory by agreement with nationals or companies of the other Contracting Party”.*⁵⁰

The Germany-India BIT 1995 departs from the above-mentioned BITs. In its Article 13(2) “Application of other rules” it provides:

“Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party, with dispute arising from such obligations being only redressed under the terms of the contracts underlying the obligations”.

47. J. Karl, in an analysis of this Model BIT, states that this clause “relates particularly to investment contracts between the investor and the host country” and that “the protection of such contracts is now a standard clause in bilateral investment agreements”. He notes that some countries are “reluctant to accept this provision which transforms responsibility incurred towards a private investor under a contract into international responsibility”. “The Promotion and Protection of German Foreign Investment Abroad”, 11 ICSID Rev.-F.I.L.J. 1, No. 1, Spring 1996 at 23.

48. Model BIT 1991(2).

49. Model BIT (No. 201).

50. This language is reproduced in a further 9 BITs.

Example 4: Treaty Practice of Japan

Only two of the 9 Japanese BITs examined in this study contain an umbrella clause. While both include the clause in a provision relating to substantive protections accorded under the BIT, the language used in each clause differs. Article 2(3) of the Japan-Hong Kong BIT 1997 reads:

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

This can be contrasted to the Japan-Russia BIT 1998 which reads in its Article 3(3):

“Each Contracting Party shall observe any of its obligations assumed in respect of the capital investments made by an investor of the other Contracting Party.”

Example 5: Treaty Practice of the United States

As mentioned above, an umbrella clause is contained in 34 of the 41 US BITs examined that are based on the former Models:

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

This clause is not present in the most recent 2004 US Model BIT. Article 24(1) of the model BIT limits the application of this clause to cover only claims stemming from an investment agreement and not other contractual obligations (Annex 2.A2).

“[...] the claimant may submit to arbitration under this Section a claim that the respondent has breached [...] c) an investment agreement.”

In its Article 26, it provides for an explicit waiver of this right:

“No claim may be submitted to arbitration under this Section unless: b) the notice of arbitration is accompanied i) for claims submitted to arbitration under Article 24(1)a by the claimant’s written waiver [...] of any right to initiate or continue before any administrative tribunal or court under the law of either Party or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24.”

The Model BIT, in its Article 1, provides for a detailed definition of an investments agreement:

“ ‘investment agreement’ means a written agreement⁵¹ that takes effect on or after the date of entry into force of this Treaty between a national authority⁵² of a Party and a covered investment or an investor of the other Party that grants the covered investment or investor rights: a) with respect to natural resources or other assets that a national authority controls; and b) upon which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself.”

III. Jurisprudence

Although as mentioned above, the umbrella clause has been a subject of discussion among scholars for some decades now, it has never been part of jurisprudence until very recently.⁵³ The first ICSID case that addressed the umbrella clause arose in 1998: *Fedax NV v. Republic of Venezuela*⁵⁴ based on the BIT between the Netherlands and the Republic of Venezuela. In this case, the tribunal was unaware that there was an umbrella clause, and did not carry out any in-depth examination of the clause or its application. It simply applied the “plain meaning” of the provision, that commitments should be observed under the BIT, to the promissory note contractual document. It found that Venezuela was under the obligation to “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”.⁵⁵ The merits of the case were partially settled by the parties.

A narrow interpretation

The first time⁵⁶ an arbitral tribunal evaluated the scope of an umbrella clause was in the *SGS Société Générale de Surveillance S.A. v. Pakistan* case,⁵⁷ (2003) based on the Pakistan-Switzerland BIT.

The Tribunal rejected SGS’s contention that this clause elevated breaches of a contract to breaches of the treaty:

“The text itself of Article 11 does not purport to state that breaches of contract alleged by an investor in relation to a contract it has concluded with a State

51. Written agreement refers to an agreement in writing, executed by both parties, whether in a single instrument or in multiple instruments, that creates an exchange of rights and obligations, binding on both parties under the law applicable under Article XX [Governing Law](2). For greater certainty, a) a unilateral act of an administrative or judicial authority, such as a permit, license, or authorisation issued by a Party solely in its regulatory capacity, or a decree, order, or judgment, standing alone; and b) an administrative or judicial consent decree or order, shall not be considered a written agreement.

52. For purposes of this definition, “national authority” means for the United States, an authority at the central level of government.

53. For a detailed discussion on all recent ICSID cases dealing with the umbrella clause see E. Gaillard, *Journal du droit international, Clunet* No. 1/2006, Janvier-Février-Mars 2006 at 326-350.

54. *Fedax NV v. Republic of Venezuela*, Award, 9 March 1998, 37 ILM 1391 (1998).

55. *Id.*, paras. 25, 29. (2002) 5 ICSID report, 186 pp.

56. The first Energy Charter Treaty tribunal in *Nycomb v. Latvia* could have rendered its judgment on the basis of the ECT umbrella clause as was proposed by the claimant, but preferred to rest its decision on national treatment. By doing so, it avoided having to decide whether, in this case, the contract’s jurisdictional clause in favour of domestic courts should be overridden by the ECT’s arbitral jurisdiction.

57. *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID case No. ARB/01/13, decision on Jurisdiction, 6 August 2003, 18 ICSID rev- F.I.L.J. 307 (2003).

(widely considered to be a matter of municipal rather than international law) are automatically ‘elevated’ to the level of breaches of international treaty law.”⁵⁸

The Tribunal added that “the legal consequences were so far-reaching in scope and so burdensome in their potential impact on the State” that “clear and convincing evidence of such an intention of the parties” would have to be proved. Such proof was not brought forward according to the Tribunal.⁵⁹ It also argued that the claimant’s interpretation “would amount to incorporating by reference an unlimited number of state contracts” the violation of which “would be treated as a breach of the treaty”.⁶⁰

It is worth noting that after the publication of the decision, the Swiss authorities explained in a letter their intention when entering into the Switzerland-Pakistan BIT as follows:

“[...] the Swiss authorities are alarmed about the very narrow interpretation given to the meaning of Article 11 by the Tribunal, which not only runs counter to the intention of Switzerland when concluding the Treaty but is quite evidently neither supported by the meaning of similar articles in BITs concluded by other countries nor by academic comments on such provisions [...] With regard to the meaning behind provisions such as Article 11 the following can be said: [...] they are intended to cover commitments that a host State has entered into with regard specific investments of an investor or investment of a specific investor, which played a significant role in the investor’s decision to invest or to substantially change an existing investment, i.e. commitments which were of such a nature that the investor could rely on them [...] It is furthermore the view of the Swiss authorities that a violation of a commitment of the kind described above should be subject to the dispute settlement procedures of the BIT.”⁶¹

The Tribunal in *Joy Mining Machinery, Ltd. v. The Arabic Republic of Egypt*⁶² interpreted the “umbrella clause” in a way similar to the *SGS v. Pakistan* tribunal, i.e. that the disputes at issue, which related to the release of bank

58. *Ibid.*, para. 166.

59. *Ibid.*, paras. 167 and 173.

60. *Ibid.*, para. 168.

61. Note on the Interpretation of Article 11 of the Bilateral Investment Treaty between Switzerland and Pakistan in the light of the Decision of the Tribunal on Objections to Jurisdiction of ICSID in Case No. ARB/01/13 *SGS Société Générale de Surveillance SA v. Islamic Republic of Pakistan*, attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy Secretary-General dated 1 October 2003, published in 19, *Mealey’s: Int’l Arb. Rep.* E3, February 2004, as referred to by E. Gaillard in “Investment Treaty Arbitration and Jurisdiction Over Contract Claims – the *SGS* Cases Considered” in *International Investment Law and Arbitration: Leading cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, Tod Weiler Editor (2005).

guarantees, were commercial and contractual disputes to be settled through the mechanism set forth by contract. It held that:

“[i]n this context, it could not be held that an umbrella clause inserted in the treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of Treaty rights and obligations or a violation of contract rights of such a magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect. This might be perfectly different in other cases where that link is found to exist, but certainly it is not the case here.”⁶³

In *Salini Costruttori S.P.A. and Italstrade S.P.A. v. The Hashemite Kingdom of Jordan*,⁶⁴ the Claimant requested the Tribunal to recognise that the Treaty [Article 2(4) of the Italy-Jordan BIT (see above in paragraph 33)], contained a commitment to observe obligations from investor-state contracts. The Tribunal did not agree and found that the only obligation Jordan had, was to “create and maintain a legal framework apt to guarantee the compliance of undertakings”:

“[...] under Article 2(4), each Contracting Party did not commit itself to ‘observe’ any ‘obligation’ it had previously assumed with regards to specific investments of investors of the other contracting Party as did the Philippines. It did not even guarantee the observance of commitments it had entered into with respect to the investments of the investors of the other Contracting Parties as did Pakistan. It only committed itself to create and maintain a legal framework apt to guarantee the compliance of all undertakings it has assumed with regards to each specific investor.”⁶⁵

In *El Paso Energy International Company v. The Argentine Republic*,⁶⁶ the Tribunal rejected the arguments advanced by the US-based energy firm

62. *Joy Mining Machinery Limited v. The Arab Republic of Egypt*, Award on Jurisdiction, ICSID case No. ARB/03/11, 6 August 2004. Joy Mining, a company incorporated under the laws of the United Kingdom initiated an ICSID arbitration pursuant to the UK-Egypt BIT. The dispute concerned a “Contract for the Provision of Longwall Mining Systems and Supporting Equipment for the Abu Tartur Phosphate Mining Project”, executed in April 1998 between Joy Mining and the General Organisation for Industrial Projects of the Arab Republic of Egypt. The parties’ disagreement related to performance tests of the equipment and to the release of guarantees. The Tribunal addressed the issue of whether bank guarantees may be considered to be an investment under the BIT. Noting that bank guarantees are simply contingent liabilities, concluded that they could not constitute assets under the BIT and were not protected investments.

63. *Idem*, para. 81.

64. *Salini Costruttori S.p.A. and Italstrade S.p.A v. The Hashemite Kingdom of Jordan*, ICSID case No. ARB/02/13), Decision on Jurisdiction, 29 November 2004, available at www.worldbank.org/icsid/cases/salini-decision.pdf.

65. *Ibid.*, para. 126.

El Paso, which would have permitted contractual breaches to be considered as breaches of the US-Argentina BIT under the treaty's wide "proper" umbrella clause provision that "each Party shall observe any obligation it may have entered into with regard to investments".

The tribunal took issue with earlier arbitral tribunals and in particular the *SGS v. Philippines* one, who had held that ambiguities in investment treaty terms should be resolved in favor of foreign investors. Instead, the El Paso tribunal called for a balanced approach to investment treaty interpretation, one which takes into account "both State sovereignty and the State's responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow".⁶⁷ This rejection of the view that interpretive doubts should be resolved in favor of foreign investor interests would guide the interpretation of the tribunal with respect the "umbrella clause" of the treaty.

It rejected a wide interpretation of the clause distancing itself from the ones which had provided broad scope for contractual breaches to be asserted as treaty breaches and aligned itself with several earlier tribunal rulings which adopted a narrow meaning.

*"In view of the necessity to distinguish the State as a merchant, especially when it acts through instrumentalities, from the States as a sovereign, the Tribunal considers that the 'umbrella clause' in the Argentine-US BIT [...] can be interpreted in the light of Article VII(1) which clearly includes among the investment disputes under the Treaty all disputes resulting from a violation of a commitment given by the State as a sovereign State, either through an agreement, an authorization, or the BIT [...] Interpreted this way, the umbrella clause read in conjunction with Article VII, will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign – such as stabilisation clause – inserted in an investment agreement."*⁶⁸

The tribunal went on to say that the broad interpretation of the so-called umbrella clauses would have "far reaching consequences, quite destructive of the distinction between national legal orders and the international legal order". In addition, it expressed its conviction that the investors "will not use appropriate restraint – why should they? – if the ICSID Tribunals offer them unexpected remedies. This responsibility for showing appropriate restraint rests rather in the hands of the ICSID Tribunals".⁶⁹

66. *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006.

67. Decision on Jurisdiction, para. 70.

68. *Idem*, para. 81.

69. *Idem*, para. 82.

Another tribunal in the case *Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic*,⁷⁰ presiding over a dispute brought by BP America and several subsidiaries of the energy firm Pan American, has followed the approach laid down in the earlier El Paso arbitration. The tribunal consisting of two of the same three arbitrators of the El Paso tribunal held that the contested provision in the US-Argentina BIT could not be considered to be an “umbrella clause” which would transform contract claims into breaches of international law. It observed that:

*“It would be strange indeed if the acceptance of a BIT entailed an international liability of the State going far beyond the obligation to respect the standards of protection of foreign investments embodied in the Treaty and rendered it liable for any violation of any commitment in national or international law ‘with regard to investments.’”*⁷¹

The Tribunal in *CMS Gas Transmission Company v. Republic of Argentina*,⁷² in its final award, found Argentina internationally responsible pursuant to the umbrella clause contained in the Article II(2)c) of the US-Argentina BIT. It expressed however the view that the application of this “proper” umbrella clause was restricted to contracts concluded between an investor and the State acting as sovereign:

*“Purely commercial aspects of a contract might not be protected by the treaty in some situations, but the protection is likely to be available when there is significant interference by governments or public agencies with the rights of the investor.”*⁷³

*“While many, if not all, such interferences are closely related to other standards of protection under the Treaty, there are in particular two stabilisation clauses contained in the License that have significant effect when it comes to the protection extended to them under the umbrella clause. The first is the obligation undertaken not to freeze the tariff regime or subject it to price controls. The second is the obligation not to alter the basic rules governing the License without TGN’s written consent.”*⁷⁴

70. *Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic*, ICSID Case No. ARB/03/13 and *BP America Production Co. and Others v. Argentine Republic*, ICSID Case No. ARB/04/8; Decision on Preliminary Objections, 27 July 2006.

71. Decision on Preliminary Objections, para. 110.

72. *CMS v. Republic of Argentina*, ICSID case No. ARB/01/8, Award 12 May 2005.

73. Award, p. 299.

74. Award, paras. 302, 303.

A wide interpretation

At the same time as the SGS brought the claim against Pakistan, it brought another case against the Philippines,⁷⁵ based on the Philippines-Switzerland BIT.⁷⁶ The Tribunal in this case examined the interpretation of the clause in the *SGS v. Pakistan* decision and although it recognised that the language of the clause was not the same, it found the decision unconvincing⁷⁷ and highly restrictive.⁷⁸ It concluded that:

*“To summarise the Tribunal’s conclusions on this point, Article X(2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the extent of content of such obligations into an issue of international law.”*⁷⁹

However, while the Tribunal took a wider reading of the scope of the umbrella clause, than the *SGS v. Pakistan* Tribunal, it required at the end that if the contract vests exclusive jurisdiction over disputes arising under its terms to another tribunal (domestic court or a contractual arbitral tribunal) then this tribunal has the primary jurisdiction. The Tribunal decided to suspend the proceedings indefinitely until the claimant got a judgment from the domestic courts and then return to it if he considered that such judgment was not satisfactory.⁸⁰

The Tribunal in *Sempra Energy International v. Argentina*⁸¹ noted that the dispute arose from “how the violation of contractual commitments with the licensees [*Sempra*] [...] impacts the rights of the investor claims to have in the light of the provisions of the treaty and the guarantees on the basis of which it made the protected investment”.⁸² It recognised that these contractual claims were also treaty claims and was reinforced in its view by the fact that:

“the Treaty also includes the specific guarantee of a general ‘umbrella clause’, [such as that of Article II(2)(c)], involving the obligation to observe contractual

75. *SGS Société Générale de Surveillance SA v. the Republic of the Philippines*, ICSID case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004, available at www.worldbank.org/icsid/cases/SGSvPhil-final.pdf.

76. On both cases, see the analysis by E. Gaillard, *op. cit.*, note 61; C. Schreuer, *op. cit.*, note 25; T. Wälde, *op. cit.*, notes 1 and 19; and S. Alexandrov in “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*” in *The Journal of World Investment and Trade*, No. 4, Vol. 5, August 2004.

77. *Ibid.*

78. *Ibid.*, paras. 119 and 120.

79. *Ibid.*, para. 128.

80. *Ibid.*, paras. 136-155 and 170-76. One of the three members of the Tribunal, Professor A. Crivellaro, dissented.

81. *Sempra Energy International v. Republic of Argentina*, ICSID case No. ARB/02/16, Decision on Objections to Jurisdiction, 11 May 2005.

82. *Idem*, para. 100.

commitments concerning the investment, creates an even closer link between the contract, the context of the investment and the Treaty.”⁸³

The Partial Award in *Eureko B.V. v. Poland*⁸⁴ examined the question of the “umbrella clause” included in the Netherlands-Poland BIT in great detail. It interpreted this provision according with its ordinary meaning as stipulated in Article 31, paragraph 1 of the Vienna Convention. It stated that:

“the plain meaning – the ‘ordinary’ meaning – of a provision prescribing that a State ‘shall observe any obligations it may have entered into’ with regard to certain foreign investments is not obscure. The phrase ‘shall observe’ is imperative and categorical. ‘Any’ obligations is capacious; it means not only obligations of a certain type, but ‘any’ – that is to say, all obligations entered into with regards to investments of investors of the other Contracting Party.”⁸⁵

It therefore concluded that Eureko’s contractual arrangements with the Government of Poland were subject to the jurisdiction of the Tribunal.⁸⁶

One analytical point in dispute before the tribunal in *Noble Ventures, Inc. v. Romania*⁸⁷ was the question of whether contractual obligations also amounted to international obligations by virtue of the “umbrella clause” in the US-Romania BIT. The tribunal, in a thorough discussion on this clause, in which it expressed its view on all previous decisions on this matter,

83. *Idem*, para. 101.

84. *Eureko B.V. v. Poland*, Partial Award, 19 August 2005, can be found at www.investmentclaims.com/decisions/Eureko-Poland-LiabilityAward.pdf.

85. *Idem*, para. 246.

86. The decision was taken by the majority of two arbitrators with the third arbitrator dissenting. In his dissenting opinion, Professor Jerzy Rajski the third member of the arbitral tribunal, declared that the majority’s jurisdictional reasoning – including its analysis of the umbrella clause – might “lead to a privileged class of foreign parties to commercial contract who may easily transform their contractual disputes with State-owned companies into BIT disputes”. Paragraph 11 of the dissenting opinion, 19 August 2005.

87. *Noble Ventures, Inc. v. Romania*, Award, 12 October 2005, ICSID Case No. ARB/01/11. The decision concerns a dispute between a US company, Noble Ventures, Inc. (“the claimant”) and Romania arising out of a privatisation agreement concerning the acquisition, management and operation of a Romanian steel mill, Combinatul Siderurgic Resita (“CSR”) and other associated assets. The privatisation agreement was entered into between the claimant and the Romanian State Ownership Fund (“SOF”). Noble Ventures paid SOF the initial instalment of the purchase price and SOF transferred to Noble Ventures its shares of CSR, comprising almost all of CSR’s equity share capital. Noble Ventures alleged, *inter alia*, that Romania failed to honour the terms of several agreements related to the control of CSR, that Romania misrepresented CSR’s assets in the tender book prepared for the privatisation, that Romania failed to carry out its obligation to negotiate debt rescheduling with state budgetary creditors in good faith, that Romania failed to provide full protection and security to its investment during a period of labour unrest in 2001, and that Romania’s initiation of insolvency proceedings were in bad faith, in violation of fair and equitable treatment, and tantamount to expropriation.

found that Article II(2)(c) of the BIT intended to create obligations and “obviously obligations beyond those specified in other provisions of the BIT itself” and by doing so it referred clearly to investment contracts. It also noted that such an interpretation was also supported by the object and the purpose rule:

“any other interpretation would deprive Article II(2)c) of practical content, reference has necessarily to be made to the principle of effectiveness [...]”

On this point, it stated that:

“a clause that is readily capable of being interpreted in this way and which would otherwise be deprived of practical applicability is naturally to be understood as protecting investors also with regard to contracts with the host State generally in so far as the contract was entered into with regard to an investment.”

It then added that by the negotiation of a bilateral investment treaty, two States may create an exception to the general separation of States’ obligations under municipal and under international law:

in the interest of achieving the objects and goals of the treaty, the host state may incur international responsibility by reason of a breach of its contractual obligation [...] the breach of contract being thus ‘internationalised, i.e. assimilated to a breach of a treaty. The “umbrella clause” introduces this exception.

The Tribunal in *LG&E v. Argentina*⁸⁸ was also called to examine the umbrella clause included in the US-Argentine BIT. It characterised the umbrella clause as one which “creates a requirement by the host State to meet its obligations towards foreign investors, including those that derive from a contract; hence such obligations receive extra protection by virtue of their consideration under the bilateral treaty”.

It had to decide whether the abrogation of the guarantees under the statutory framework (Gas Law) – calculation of the tariffs in dollars before conversion to pesos, semi-annual tariff adjustments and no price controls without indemnification – violated Argentina’s obligations to LG&E’s investments. It concluded in the positive, by expressing the view that the provisions of the Gas Law obligations were not legal obligations of a general nature but were very specific in relation to LG&E’s investment in Argentina. It stated that “these laws and regulations became obligations [...] that gave rise to liability under the umbrella clause” of the treaty.

Two tribunals, although not confronted with an umbrella clause, expressed their views as for the meaning of such a clause. In *Waste*

88. *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. the Argentine Republic*, ICSID case No. ARB/02/1, Decision on Liability, 3 October 2006, paras. 169-175.

Management v. United Mexican States,⁸⁹ the NAFTA Tribunal, expressed its view on the “umbrella clause” although NAFTA Chapter 11 does not contain such a clause. It observed that:

“NAFTA Chapter 11 – unlike many bilateral and regional investment treaties, does not provide jurisdiction in respect of breaches of investment contracts such as [the Concession Agreement]. Nor does it contain an ‘umbrella clause’ committing the host state to comply with its contractual commitments” [emphasis added].

Along the same lines, the Tribunal in *Consorzio Groupement L.E.S.I.-DIPENTA v. Republic of Algeria*,⁹⁰ although it held that the BIT between Italy and Algeria did not contain an umbrella clause, it stated that:

“the effect of such clauses is to transform the violations of the State’s contractual commitments into violations of the treaty umbrella clause and by this to give jurisdiction to the Tribunal over the matter [...]”⁹¹ [translation by the Secretariat].

IV. Summary remarks

The umbrella clause made its appearance in investment agreements since the 1950s. It has been a regular, although not omnipresent, feature of bilateral investment treaties. Until recently, it had retained only the attention of scholars, who in their majority considered it as a clause elevating contractual obligations to treaty obligations. No arbitral tribunal had yet considered the issue until the ones arbitrating the *SGS v. Pakistan and v. Philippines* cases. Since then, it has attracted considerable discussions both by arbitral tribunals and scholars. The interpretation by the Swiss authorities of the clause, in the aftermath of the *SGS v. Pakistan* Decision on Jurisdiction, is the only interpretation by a State expressing what its intention had been at the time of the inclusion of that clause into its treaties – in the circumstance, to subject contractual commitments to treaty disciplines.

89. *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award, 30 April 2004, para. 73, in www.economiasnci.gob.mx/sphp_pages/importa/sol_control/consultoria/Casos_Mexico/Waste_2management/laudo/laudo_ingles.pdf.

90. *Consorzio Groupement L.E.S.I.-DIPENTA v. République algérienne démocratique et populaire*, ICSID case No. ARB/03/08, Award, 10 January 2005, in www.worldbank.org/icsid/cases/lesi-sentence-fr.pdf.

91. *Idem*, para. 25ii). “[...] Cette interprétation est confirmée a contrario par la rédaction que l’on trouve dans d’autres traités. Certains traités contiennent en effet ce qu’il est convenu d’appeler des clauses de respect des engagements ou « umbrella clauses ». Ces clauses ont pour effet de transformer les violations des engagements contractuels de l’État en violation de cette disposition du traité et, par là-même, de donner compétence au tribunal arbitral mis en place en application du traité pour en connaître [...]”.

There is diversity in the way the umbrella clause is formulated in investment agreements. Because of this diversity, the proper interpretation of the clause depends on the specific wording of the particular treaty, its ordinary meaning, context, the object and purpose of the treaty as well on negotiating history or other indications of the parties' intent. The review of the language of this clause included in a representative sample of treaties indicate that, although there are some disparities, the ordinary meaning of "shall observe" "any commitments/obligations" seem to point towards an inclusive, wide interpretation which would cover all obligations assumed/entered into by the contracting States, including contracts, unless otherwise stated. A different wording such as "shall guarantee the observance" or "shall maintain a legal framework apt to guarantee the continuity of legal treatment" might lead to a narrower interpretation. On the other hand, there are clauses which specifically exclude the jurisdiction of the treaty-based arbitral tribunal in favour of an administrative tribunal or a court, by preserving the distinctive jurisdictional order for the existing contracts.

Arbitral tribunals, in their majority, when faced with a "proper" umbrella clause, i.e. one drafted in broad and inclusive terms, seem to be adopting a fairly consistent interpretation which covers all state obligations, including contractual ones. At the same time, prudence requires to recognise that no conclusions can be drawn as for the interpretation of the clause since jurisprudence is constantly evolving. Case-by-case consideration which may shed additional light will continue to be called for. In addition, further interpretations by governments which are parties to investment agreements including an umbrella clause, as for their intention regarding this clause, as well as the insertion of clear language in new treaties, would be a welcome and much needed development.

ANNEX 2.A1

Examples of Umbrella Clauses

Model clauses and standard clauses

Austria model BIT⁹²

Article 9. Other obligations

(1) Each Contracting Party shall observe any obligation it may have entered into with regard to specific investments by investors of the other Contracting Party.

Belgium and Luxembourg-Albania BIT 1999⁹³

Article 9. Accords particuliers

(2) Chacune des Parties contractantes assure à tout moment le respect des engagements qu'elle aura pris envers les investisseurs de l'autre Partie contractante.⁹⁴

92. This umbrella clause is also found in BITs concluded with the following countries: Armenia (2001); Bosnia and Herzegovina (2000); Jordan (2001); Libya (2002); the Former Yugoslav Republic of Macedonia (2001); Oman (2001); Slovenia (2001); United Arab Emirates (2001); Uzbekistan (2000).

93. See also BITs concluded with: Algeria (1991); Bolivia (1990); Estonia (1996); Georgia (1993); Latvia (1996); Lithuania (1997); Republic of Moldova (1996); Mongolia (1992); Paraguay (1992); Ukraine (1996); Uruguay (1991). BITs concluded with Benin (2001), Burkina Faso (2001), Comoros (2001), The Former Yugoslav Republic of Macedonia (1999) contain the same language with the exception "envers les investisseurs" is replaced by "à l'égard des investisseurs".

94. This umbrella clause is repeated in 15 other BITs concluded by Belgium and Luxembourg: Algeria (1991); Bolivia (1990); Estonia (1996); Georgia (1993); Latvia (1996); Lithuania (1997); Republic of Moldova (1996); Mongolia (1992); Paraguay (1992); Ukraine (1996); Uruguay (1991). BITs concluded with Benin (2001), Burkina Faso (2001), Comoros (2001), The Former Yugoslav Republic of Macedonia (1999) contain the same language with the exception "envers les investisseurs" is replaced by "à l'égard des investisseurs".

Denmark model BIT⁹⁵*Article 3. Promotion and protection of investments*

(3) Each Contracting Party shall observe any obligation it may have entered into with regard to investment of investors of the other Contracting Party.

Finland model BIT⁹⁶*Article 12. Application of other rules*

(2) Each Contracting Party shall observe any other obligation it may have with regard to a specific investment of an investor of the other Contracting Party.

German model BIT 1991(2)⁹⁷*Article 8.*

(2) Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party.

German model BIT (No. 201)⁹⁸*Article 8.*

(2) Each Contracting State shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting State.

95. The Model BIT language is repeated in BITs with the following states: Algeria (1999); Bulgaria (1993); Chile (1993); Croatia (2000); Cuba (2001); Egypt (1999) [not in force]; Estonia (1991); Ethiopia (2001) [not in force]; Ghana (1992); Hong Kong (1994); Kyrgyzstan (2001) [not in force]; People's Democratic Republic of Lao (1998); Latvia (1992); Lithuania (1992); Mongolia (1995); Nicaragua (1995); Pakistan (1996); Philippines (1997); Poland (1990); Slovenia (1999); Turkey (1990); Uganda (2001) [not in force]; Ukraine (1992); United Republic of Tanzania (1999) [not in force].

96. See also BITs concluded with: Bosnia and Herzegovina (2000); Kyrgyzstan (2003); Nicaragua (2003) [not in force] and; United Republic of Tanzania (2001).

97. The Model BIT is followed in BITs with: Barbados (1994); Botswana (2000) [not in force]; Cambodia (1999); Guyana (1989); Hong Kong (1996) [but replaces "territory" with "area"]; Jamaica (1992); Kenya (1996); Namibia (1994); Sri Lanka (2000); Zimbabwe (1995).

98. This umbrella clause is reproduced in BITs with the following countries: Antigua and Barbuda (1998); Bosnia and Herzegovina (2001) [not in force]; Lebanon (1997); Nigeria (2000); Philippines (1997); Thailand (2002).

Greek model BIT 2001⁹⁹

Article 11. Application of other rules

(2) Each Contracting Party shall observe any obligation it may have entered into with regard to a specific investment of an investor of the other Contracting Party.

Korea-Belarus BIT 1997¹⁰⁰

Article 10. Application of other rules

(3) Each Contracting Party shall observe any other obligation it may have entered into with regard to investments in its territory by investors of the other Contracting Party.

Netherlands model BIT¹⁰¹

Article 3(4).

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

Sweden model BIT 2002¹⁰²

Article 2. Promotion and protection of investment

(4) Each Contracting Party shall observe any obligation it has entered into with investors of the other Contracting Party with regard to their investment.

99. Greece-Turkey BIT 2000.

100. See also BITs concluded with: Algeria (1999); Costa Rica (2000); El Salvador (1998); Guatemala (2000); Honduras (2000); Hong Kong (1997); Nicaragua (2000); Panama (2001); Qatar (1999); Romania (1990); Saudi Arabia (2003) [not in force]; South Africa (1995); Tajikistan (1995); Trinidad and Tobago (2002); Ukraine (1996); Vietnam (2003).

101. The model BIT umbrella clause is reproduced in BITs with the following countries: Albania (1994); Bangladesh (1994); Belarus (1995); Bolivia (1992); Bosnia and Herzegovina (1998); Chile (1998); Croatia (1998); Egypt (1996); Estonia (1992); Gambia (2002); Georgia (1998); Ghana (1989); Honduras (2001); Indonesia (1994); Jamaica (1991); Jordan (1997); Kazakhstan (2002); People's Democratic Republic of Lao (2003); The Former Yugoslav Republic of Macedonia (1998); Republic of Moldova (1995); Mongolia (1995); Mozambique (2001); Namibia (2002); Nicaragua (2000); Paraguay (1992); Peru (1994); Slovenia (1996); Tajikistan (2002); Tunisia (1998); Ukraine (1994); Uruguay (1988); Uzbekistan (1996); Vietnam (1994); Zambia (2003); Zimbabwe (1996).

102. Sweden-Bosnia Herzegovina BIT 2000.

Switzerland model BIT¹⁰³*Article 10. Other commitments*

(2) Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party.

United Kingdom model BIT¹⁰⁴*Article 2. Promotion and protection of investment*

(2) [...] 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.

US-Argentina BIT 1991¹⁰⁵*Article 2.*

(2)(c) Each Party shall observe any obligation it may have entered into with regard to investments.

103. See also BITs concluded with: Argentina (1991); Belarus (1993); Cape Verde (1991); Estonia (1992); Gambia (1993); Ghana (1991); Honduras (1993); People's Democratic Republic of Lao (1996); Latvia (1992); Lithuania (1992); Former Yugoslav Republic of Macedonia (1995); Nicaragua (1998); Pakistan (1995); Paraguay (1992); Peru (1991); Slovakia (1990); Turkey (1988); Uruguay (1988); Uzbekistan (1993); Vietnam (1992); Zambia (1994).

104. The umbrella clause in the model BIT is repeated in the BITs with the following countries: Albania (1994); Angola (2000); Antigua and Barbuda (1987); Armenia (1993); Azerbaijan (1996); Bahrain (1990); Bangladesh (1980); Barbados (1993); Belarus (1994); Belize (1982); Benin (1987); Bulgaria (1995); Burundi (1990); China (1986); Congo (1989); Côte d'Ivoire (1995); Croatia (1997); Cuba (1995); Dominica (1987); Ecuador (1994); Egypt (1997); Estonia (1994); Georgia (1995); Grenada (1988); Guyana (1989); Haiti (1985); Honduras (1993); Indonesia [Article 3] (1976); Jordan (1979); Kazakhstan (1995); Republic of Korea (1976); Kyrgyzstan (1994); People's Democratic Republic of Lao (1995); Latvia (1994); Lesotho (1981); Lithuania (1993); Malaysia (1981); Malta (1986); Mauritius (1986); Republic of Moldova (1996); Mongolia (1991); Nepal (1993); Nicaragua (1996); Nigeria (1990); Oman (1995); Pakistan (1994); Panama (1983); Papua New Guinea (1981); Paraguay (1981); Peru (1983); Poland (1987); Saint Lucia (1983); Senegal (1980); Sierra Leone (2000); Singapore (1975); Slovenia (1996); South Africa (1994); Sri Lanka (1980); Swaziland (1995); Tonga (1997); Turkey (1991); Turkmenistan (1995); Uganda (1998); United Republic of Tanzania (1994); Uruguay (1991); Vietnam (2002); Yemen (1982); Zimbabwe (1995).

105. See also BITs concluded with: Armenia (1992); Bulgaria (2003); Congo (1990); Ecuador (1993); Estonia (2003); Grenada (1986); Jamaica (1994); Kazakhstan (1994); Kyrgyzstan (1993); Latvia (2003); Lithuania (2003); Republic of Moldova (2003); Mongolia (1994); Morocco (1985); Romania (2003); Sri Lanka (1991); Ukraine (1994).

Clauses of note

Australia-Chile BIT 1996/China BIT 1988

Article 11. Undertakings given to investors

A Contracting Party shall, subject to its law, adhere to any written undertakings given by a competent authority to a national of the other Contracting Party with regard to an investment in accordance with its law and the provisions of this Agreement.

Australia-Hong Kong BIT 1993

Article 2. Promotion and protection of investment and returns

(2) [...] Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party.

Australia-Poland BIT 1991

Article 10. Undertakings given to investors

A Contracting Party shall, subject to its law, do all in its power to ensure that a written undertaking given by a competent authority to a national of the other Contracting Party with regard to an investment is respected.

Austria-Chile BIT 1997

Article 2. Promotion, admission and protection of investments

(4) Each Contracting Party shall observe any contractual obligation it may have entered into towards an investor of the other Contracting Party with regard to investments approved by it in its territory.

Belgium and Luxembourg-Malta BIT 1987

Article 8.

(1) Where a dispute arises between an investor of one of the Contracting Parties and the other Contracting Party affecting an investment of the former and relating to a matter with respect to which the latter has undertaken an obligation in favour of the other Contracting Party under this Agreement, such a dispute shall in the first instance be dealt with in pursuit of local remedies, unless some other method, including arbitration, has been agreed between the investor and the Contracting Party.

Czech Republic-Singapore BIT 1995*Article 15. Other obligations*

(2) Each Contracting Party shall observe commitments, additional to those specified in this Agreement, it has entered into with respect to investments of the investors of the other Contracting Party. Each Contracting Party shall not interfere with any commitments, additional to those specified in this Agreement, entered into by nationals or companies with the nationals or companies of the other Contracting Party as regards their investments.

Finland-Estonia BIT 1992*Article 4. Most favoured nation provisions*

(1) [...] Each Contracting Party shall observe any obligation it may have entered into with regard to investments.

France-Peru BIT 1993*Article 2.*

Les investissements ayant fait l'objet d'un engagement particulier de l'une des Parties contractantes à l'égard des nationaux et sociétés de l'autre Partie contractante sont régis, sans préjudice des dispositions du présent Accord, par les termes de cet engagement dans la mesure où celui-ci comporte des dispositions plus favorables que celles qui sont prévues par le présent Accord.

France-Yemen BIT 27 April 1984*Article 2. Encouragement et protection des investissements*

(2) [...] Chaque Partie contractante s'engage à honorer les obligations qu'elle peut avoir contractées relativement aux investissements des nationaux ou sociétés de l'autre Partie contractante.

Greece-Serbia and Montenegro BIT 1997*Article 2. Promotion and protection of investment*

(4) Each Contracting Party shall, in its territory, respect in good faith all obligations concerning a particular investor of the other Contracting Party undertaken within its legal framework.

France-Mexico BIT 1998*Article 10. Special commitments*

(2) Chacune des Parties contractantes respecte tout autre engagement qu'elle a contracté par écrit au titre des investissements réalisés sur son

territoire par des investisseurs de l'autre Partie contractante. Les différends soulevés au sujet de ces engagements sont réglés conformément aux conditions des contrats régissant lesdits engagements.

Netherlands-Philippines BIT 1985

Article 3(3).

Each Contracting Party shall observe any obligation arising from a particular commitment it may have entered into with regard to a specific investment of nationals of the other Contracting Party.

UK-Philippines BIT 1980

Article 3(3).

Each Contracting Party shall observe any obligation arising from a particular commitment it may have entered into with regard to a specific investment of nationals or companies of the other Contracting Party.

ANNEX 2.A2

*2004 US Model Bilateral Investment Treaty***Article 24: Submission of a Claim to Arbitration**

1. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation:

- a) the claimant, on its own behalf, may submit to arbitration under this Section a claim
 - i) that the respondent has breached
 - (A) an obligation under Articles 3 through 10,
 - (B) an investment authorisation, or
 - (C) an investment agreement; and
 - ii) that the claimant has incurred loss or damage by reason of, or arising out of, that breach; and
- b) the claimant, on behalf of an enterprise of the respondent that is a juridical person that the claimant owns or controls directly or indirectly, may submit to arbitration under this Section a claim
 - i) that the respondent has breached
 - A) an obligation under Articles 3 through 10,
 - B) an investment authorisation, or
 - C) an investment agreement; and
 - ii) that the enterprise has incurred loss or damage by reason of, or arising out of, that breach, provided that a claimant may submit pursuant to subparagraph a)i)(C) or b)i)(C) a claim for breach of an investment agreement only if the subject matter of the claim and the claimed damages directly relate to the covered investment that was established or acquired, or sought to be

established or acquired, in reliance on the relevant investment agreement.

2. [...]

Article 26: Conditions and Limitations on Consent of Each Party

1. No claim may be submitted to arbitration under this Section if more than three years have elapsed from the date on which the claimant first acquired, or should have first acquired, knowledge of the breach alleged under Article 24(1) and knowledge that the claimant [for claims brought under Article 24(1)a)] or the enterprise [for claims brought under Article 24(1)b)] has incurred loss or damage.

2. No claim may be submitted to arbitration under this Section unless:

a) the claimant consents in writing to arbitration in accordance with the procedures set out in this Treaty; and

b) the notice of arbitration is accompanied,

i) for claims submitted to arbitration under Article 24(1)a), by the claimant's written waiver, and

ii) for claims submitted to arbitration under Article 24(1)b), by the claimant's and the enterprise's written waivers

of any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24.

3. Notwithstanding paragraph 2b), the claimant [for claims brought under Article 24(1)a)] and the claimant or the enterprise [for claims brought under Article 24(1)b)] may initiate or continue an action that seeks interim injunctive relief and does not involve the payment of monetary damages before a judicial or administrative tribunal of the respondent, provided that the action is brought for the sole purpose of preserving the claimant's or the enterprise's rights and interests during the pendency of the arbitration.