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Umbrella Clauses

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Table of Contents

Abbreviations	2
Cases cited in the paper with abbreviations used in the text.....	3
Introduction	5
Part 1 Jurisdiction of international arbitral tribunals over contract claims and the role of the umbrella clause	8
I State contracts and exclusive forum selection clauses.....	8
II Distinction between contract claims and treaty claims.....	8
III Irrelevance of dispute settlement clauses in state contracts for tribunals’ jurisdiction over treaty claims.....	9
IV Jurisdiction over contract claims and the umbrella clause – current approach.....	9
V Jurisdiction over contract claims and the umbrella clause – new approach.....	11
Part 2 Arguments <i>pro & contra</i> the umbrella clause’s effect – does it have any effect at all? 17	
I Rules on the interpretation of treaties and the interpretation of the umbrella clause	17
II The umbrella clause as a provision “susceptible of almost indefinite expansion”.....	21
III The umbrella clause as an exception from the general rule; no evidence for the intent of the Contracting Parties	22
IV Other substantial BIT standards would be rendered superfluous	24
V The existence of an exclusive dispute settlement clause in a state contract.....	28
VI Location of the umbrella clause in the BIT.....	30
Part 3 Different wordings – different scopes? How far do the umbrella clause’s effects go?. 32	
I Scope of obligations covered by umbrella clauses	32
II Scope of violations of obligations covered.....	36
Conclusions	38
Bibliography and abbreviations used in the text	40

Abbreviations

Art.	Article
BIT	Bilateral Investment Treaty
ECT	Energy Charter Treaty
e.g.	example given
f.	following
ICSID	International Center for the Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of other States
<i>Ibid.</i>	<i>Ibidem</i>
<i>Id.</i>	<i>Idem</i>
<i>i.e.</i>	<i>id est</i>
NAFTA	North American Free Trade Agreement
P(p).	Page(s)
Par.	Paragraph
U.S.A.	United States of America
v.	versus

Cases cited in the paper with abbreviations used in the text

I Cases with a narrow interpretation of the umbrella clause

SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ICSID Case No. ARB /01/13, Decision on Jurisdiction, 6 August 2003 (*SGS v. Pakistan*).

Joy Mining Machinery Limited v. The Arab Republic of Egypt, ICSID Case No. ARB/03/11, Decision on Jurisdiction, 6 August 2004 (*Joy Mining v. Egypt*).

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 (*Salini v. Jordan*).

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

Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic, ICSID Case No. ARB/03/13, 27 July 2006 (*Pan American v. Argentina*).

II Cases with a broad interpretation of the umbrella clause

Fedax N.V. v. Republic of Venezuela, ICSID Case No. ARB/96/3, Award, 9 March 1998 (*Fedax v. Venezuela*).

SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004 (*SGS v. Philippines*).

Conorzio Groupement L.E.S.I. – DIPENTA v. Democratic and popular Republic of Algeria, ICSID Case No. ARB/03/08, Award, 10 January 2005 (*L.E.S.I. DIPENTA v. Algeria*).

CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005 (*CMS v. Argentina II*).

Eureko B.V. v. Republic of Poland, Ad Hoc Investment Treaty Case, Partial Award on Liability, 19 August 2005 (*Eureko v. Poland*).

Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, Award, 12 October 2005 (*Noble Ventures*).

LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006 (*LG&E v. Argentina*).

III Other cases cited in the paper

Compañía de Aguas del Aconquija, S. A. and Vivendi Universal v. Argentine Republic, ICSID Case No. ARB/97/3, Award, 21 November 2000 (*Vivendi I*).

Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Decision on Jurisdiction, 8 December 2003 (*Azurix v. Argentina*).

Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001 (*Salini v. Morocco*).

Compañía de Aguas del Aconquija, S. A. and Vivendi Universal v. Argentine Republic, ICSID Case No. ARB/97/3, Decision on Annulment, 3 July 2002 (*Vivendi II*).

CMS Gas Transmission Company v. Republic of Argentina, ICSID Case No. ARB/01/8, Decision on Jurisdiction, 17 July 2003 (*CMS v. Argentina I*).

Tecnicas Medioambientales TECMED S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003 (*TECMED v. Mexico*).

Introduction

The umbrella clause (also labelled *pacta sunt servanda* clause, mirror effect clause, observation of commitments clause, observance of undertakings clause or sanctity of contract clause) is a provision that appears in a large number of today's BITs and in the multilateral Energy Charter Treaty.¹ Although observation of commitments clauses are usually quite similar, their exact wordings may differ slightly from BIT to BIT and these differences may cause significant divergences in their interpretation. In its most comprehensive version the umbrella clause reads:

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

At first sight, one would think that such a provision is superfluous, given the general principle of law that one must observe the commitments he has entered into, also known as the principle of *pacta sunt servanda*. However, clear legal objectives lead to the emergence of this clause.

Umbrella Clauses were first introduced into international law long before widespread BIT practice. At the time where investor-to-state arbitration was still to come, the only chance for an investor to be protected from illicit acts of the host state – often inefficient remedies within the host state's judicial system aside – was by way of diplomatic protection. As a rule of customary international law, a state can only exercise its right of diplomatic protection if its national has been injured through a breach of international law². Now, according to another widely accepted rule of customary international law, a breach by a state of a contract with an alien does not, by itself, constitute a breach of international law³. In other words, normally a state does not engage its international responsibility if it breaches a contract it has entered into with a national of another state.

As a consequence, before the invention of the umbrella clause, breaches of contract by the host state could not give rise to diplomatic protection, unless such treatment exceptionally constituted not only a violation of the contract but at the same time a breach of a rule of

¹ See Art. 10(1) last sentence ECT; NAFTA, by contrast, does not contain a sanctity of contract clause.

² Art. 1 of the Draft Articles on Diplomatic Protection, adopted by the International Law Commission in 2006, puts it as follows: “diplomatic protection consists of the invocation by a State [...] of the responsibility of another State for an injury caused by an *internationally wrongful act* of that State to a natural or legal person that is a national of the former State” [Emphasis added].

³ *Schwebel*, Breach of Contract, p. 426.

customary international law, which was and still is the case if, e.g., the state's acts amount to denial of justice, expropriation without compensation or arbitrary treatment.

The umbrella clause was developed for the main purpose of making diplomatic protection available not only for such evident breaches of international law but also for simple violations by a state of contracts. By establishing so-called "umbrella treaties" (*i.e.* treaties containing not much more than an umbrella clause), states imposed on each other the (international law) duty to observe all commitments they had entered into with regard to foreign investors of the other state. This had the consequence that any failure to abide by these obligations/commitments would henceforth constitute a breach of international (treaty) law and would thus pave the way for diplomatic protection even if the acts were not in breach of customary international law.⁴

However, the reluctance of states in the exercise of their right to diplomatic protection very much limited the practical relevance of the umbrella clause. Thus, this provision lay dormant for a long period of time. The situation could have radically changed when direct investor-state arbitration became available. From that moment on, any investor whose home state had entered into a BIT containing an umbrella clause with the host state and whose rights under, e.g., a contract with the host state, had been violated, could have brought before the agreed international arbitral forum a claim based on the sanctity of contract clause. Nevertheless, for some inscrutable reason, it was not before 2003 that the first ICSID Tribunal had to decide upon such a claim and analysed the provision in some depth. This was the Tribunal in *SGS v. Pakistan*.

This Tribunal was confronted with the following simple argument: the umbrella clause states that "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."⁵ Thus, if the host state fails to guarantee the observance of its commitments – in other words, if it violates them – this constitutes a breach of the umbrella clause. Since Pakistan had allegedly violated a contract (the "Pre-Shipment-Inspection Agreement") it had entered into with SGS, SGS argued that it was entitled to a BIT claim on the basis of the sanctity of contract clause. For a number of reasons that will be outlined

⁴ For a more detailed analysis of the historical origins of the umbrella clause and their emergence in BITs read *Sinclair*, *Origins of the Umbrella Clause*.

⁵ *SGS v. Pakistan*, par. 163.

in some detail below, the Tribunal did not follow this argument, rejected the respective claim and gave the umbrella clause a rather restrictive and vague meaning.

Only a few months later, the Tribunal in *SGS v. Philippines* had to analyze a sanctity of contract clause that was drafted in only slightly different terms. In doing so, it came to a drastically different conclusion. The Tribunal found that the umbrella clause had exactly the effect of which the former Tribunal, in its interpretation, had deprived it: that of elevating breaches of contract to breaches of international law.

Since the decision in *SGS v. Philippines*, a number of other ICSID tribunals have had to interpret umbrella clauses. Despite their similarity, again, different tribunals interpreted the *pacta sunt servanda* clauses in totally conflicting ways and the different reasoning of the tribunals has caused a lot more confusion than clarity in the interpretation of umbrella clauses.

Therefore, it is time for a deeper analysis of this provision. As will be shown in Part 1, part of the confusion that has arisen can be avoided if the question of interpreting the umbrella clause is not mixed up with the question of whether a tribunal may exercise jurisdiction over contract claims. Part 2 outlines the most current arguments used for and against an excessively narrow interpretation of the umbrella clause and will show that a wide interpretation of this provision is clearly preferable. Part 3 deals with the different scopes of application which those tribunals which interpreted the umbrella clause broadly, accorded to it.

Part 1 Jurisdiction of international arbitral tribunals over contract claims and the role of the umbrella clause

I State contracts and exclusive forum selection clauses

In today's investment practice it is very common that the investor and the host state, before assets are effectively moved into the host country, enter into an agreement by which they give the investment a specific legal framework. Frequently the investor manages to obtain from the host state legal commitments or guarantees that go further than those contained in existing BITs. Those agreements are usually referred to as "state contracts". Among them figure the so-called "concession contracts", state contracts that grant the investor concessions such as the right to operate water sewage in a certain area for a determined period of time.

It frequently occurs that during the negotiations between host state and investor, the former insists on introducing into the contract a dispute resolution clause referring any dispute arising from the contract to its domestic courts or to arbitration under its domestic law. This occurred, e.g. during the negotiations between SGS Société Générale de Surveillance S.A. (SGS) and Pakistan, where SGS proposed UNCITRAL arbitration and Pakistan insisted on domestic arbitration. Since this was considered a "deal-breaker" for Pakistan, SGS conceded.⁶

II Distinction between contract claims and treaty claims

Such forum selection clauses in state contracts of course give respondents in international investment arbitration some ground for objections to jurisdiction. The ICSID Tribunal in *Vivendi I*, for example, had to deal with the argument that "the only claims presented by Claimants relate to rights and obligations of the parties under Concession Contract and that, accordingly, Article 16.4 of the Concession Contract requires that Claimants submit those claims to the contentious administrative tribunals of Tucumán."⁷ In order to counter this argument tribunals usually hold that contract claims as claims based on alleged violations of the contract on the one hand and treaty claims as claims based on alleged violations of the BIT on the other hand must be distinguished and that the effect of the dispute settlement clause in the contract on the tribunal's jurisdiction needs to be considered separately for

⁶ *SGS v. Pakistan*, par. 157. The wording of the clause can be found in par. 158.

⁷ *Vivendi I*, par. 41.

either type of claims. In other words, by making this distinction, the tribunal has two questions to answer. First, whether the dispute resolution clause ousts its jurisdiction over contract claims, and second whether it ousts its jurisdiction over treaty claims. While the Tribunal in *Vivendi I* had difficulties in distinguishing contract from treaty claims and namely spoke of “the impossibility [...] of separating potential breaches of contract claims from BIT violations”⁸, most tribunals that were subsequently confronted with similar arguments (namely that due to the forum selection clause, the tribunal must decline jurisdiction over any claim raised by the claimant) clearly drew the distinction between contract and treaty claims.⁹ This distinction is today “now well-recognised in investment treaty arbitration.”¹⁰

III Irrelevance of dispute settlement clauses in state contracts for tribunals’ jurisdiction over treaty claims

While the Tribunals’ decisions in the cases cited in footnote 9 differed in as far as their jurisdiction over contract claims was concerned, the Tribunals uniformly upheld jurisdiction over treaty claims in spite of the existence of forum selection clauses in the state contract.¹¹ As Gaillard puts it, “[t]he authority resulting from these cases [...] is that the investor has a right to seek the international responsibility of the host State on the basis of the applicable investment treaty notwithstanding the forum selection clause contained in the investment agreement.”¹²

IV Jurisdiction over contract claims and the umbrella clause – current approach

By contrast, no real authority arises from tribunals’ decisions with respect to their jurisdiction over contract claims. What is worse, since no clear line of reasoning has so far been found, the arguments used have caused considerable confusion regarding the role of the umbrella clause. Let us have a look at the circumstances under which tribunals have accepted jurisdiction over contract claims.

⁸ *Ibid.*, par. 81.

⁹ See, e.g., *Salini v. Morocco*, par. 59, 61 and 62; *Vivendi II*, par. 60; *SGS v. Pakistan*, par. 161 or *SGS v. Philippines*, par. 130-135

¹⁰ Gaillard, *SGS Cases*, 328.

¹¹ See *Vivendi I*, par. 54; *Salini v. Morocco*, par. 63; *SGS v. Pakistan*, par. 190 (a); *SGS v. Philippines*, par. 177 (a).

¹² Gaillard, *SGS Cases*, 328.

Schreuer, giving an overview of this issue, notes: “There are several situations in which the tribunal may deal also with claims arising from an alleged breach of contract.”¹³ Following this statement, he describes three alternative situations in which a tribunal is competent to hear contract claims:

Situation 1 – The first one is given where the “Breach of Contract Amount[s] to [a] Breach of International Law”¹⁴. While affirming that “[n]ot every breach of contract by a State [...] amounts to a violation of international law”, *Schreuer* states that this is however the case where “a breach of contract violates the standards guaranteed by [the applicable] BIT”¹⁵ [Emphasis added]. Thus, if a violation of the contract violates “the principle of fair and equitable treatment, the prohibition of unreasonable or discriminatory measures or the prohibition of measures having effect equivalent to nationalisation”¹⁶, this violation constitutes, as well, a breach of the BIT. For instance, “[i]nternational courts and tribunals have held repeatedly that measures by a State, affecting rights under a contract, may amount to an expropriation.”¹⁷

Situation 2 – The second situation in which, according to *Schreuer*, “an international tribunal is competent for contract claims”¹⁸ arises if the “[c]ompetence of [the] Tribunal Extend[s] to All Investment Disputes”¹⁹. In fact, many BITs contain very broad dispute settlement clauses referring to ICSID arbitration “[a]ny dispute relating to investments [...] between one of the Contracting Parties and an investor of the other Contracting Party”²⁰. From its wording alone, this provision does not seem to exclude disputes that arise from alleged violations of a contract, as long as they are related to an investment. However, tribunals have not always accepted this view and occasionally declined jurisdiction over contract claims under these circumstances.²¹

Situation 3 – Thirdly, *Schreuer* explains, an international tribunal is competent to hear contract claims if the applicable BIT contains an umbrella clause by which “the State parties undertake to observe any obligations they may have entered into with respect to

¹³ *Schreuer*, Vivendi I Case, 295.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*, 296.

¹⁷ *Ibid.*

¹⁸ *Ibid.*, 296.

¹⁹ *Ibid.*

²⁰ Art. 8 (1) of the French-Argentina BIT; for the full wording see *Vivendi I*, Appendix 1 A.

²¹ For more detail see on this matter see *Schreuer*, Vivendi I Case, 296-299 and *Gaillard*, SGS Cases, 331-336.

investments”. Under this provision “violations of the contract become treaty violations”.²² A number of scholars share this view²³, just as some international arbitral tribunals have shared it.²⁴ Other tribunals however held that the umbrella clause can not at all have this effect, raising a number of arguments that will be discussed in detail further below. *Schreuer* made a good point in stating that “[d]espite the apparent clarity of these clauses, they have led to considerable confusion and to conflicting decisions by tribunals.”²⁵

The following remarks will probably not avoid conflicting decisions by tribunals in the future. But hopefully they will help resolve some of the confusion that has arisen with respect to umbrella clauses, jurisdiction over contract claims and the effect of dispute settlement clauses in state contracts.

V Jurisdiction over contract claims and the umbrella clause – new approach

Ad situation 1: jurisdiction over contract claims – really?

As discussed in the above paragraphs, it is sometimes said that tribunals can exercise jurisdiction over contract claims if the breach of the contract amounts to a breach of international law (first situation above). While this seems to be evident at first sight, a closer look should make clear that – in actual fact – this is not the case.

In *TECMED v. Mexico*, Mexico had contractually guaranteed the investor to keep current the existing licenses necessary for the operation of a landfill.²⁶ Mexico, however, did not renew the licenses, forcing the investor to stop its activities in the field of hazardous waste. The Tribunal held that the fact of denying renewal of permits constituted an indirect illegal expropriation and thus a violation of the relevant BIT.²⁷

Undoubtedly, in this case, the non-renewal of the licenses was not only in violation of the BIT, *but also* in violation of the contract. Therefore, *TECMED* could have raised – in addition to the treaty claim alleging an illegal expropriation – a distinct claim before the ICSID Tribunal: namely a contract claim alleging that the contract has been violated. In

²² *Ibid.*, 299.

²³ See, for instance, *Mann*, *British Investment Treaties*, 245; *Sornarajah*, *Foreign Investment Law*, 248; *Vandenvelde*, *U.S. Investment Treaties*, 78.

²⁴ *SGS v. Philippines*, par. 128; *L.E.S.I. DIPENTA v. Algeria*, par. 25; *Noble Ventures*, par. 62; *LG&E v. Argentina*, par. 175.; *Eureka v. Poland*, par. 260.

²⁵ *Ibid.*

²⁶ *TECMED v. Mexico*, par. 90.

²⁷ *Ibid.*, par. 95-151.

other words, the same set of facts, namely the non-renewal of the license, gave at the same time rise to a BIT claim and to a contract claim. Claimant however based his claim on the alleged violation of the BIT exclusively. This does not mean that he could not simultaneously have based it on the other legally binding instrument – the contract.

The Tribunal in *Noble Ventures* stressed this in a similar way:

“It may be further added that, inasmuch as a breach of contract at the municipal level creates at the same time the violation of one of the principles existing either in customary international law or in treaty law applicable between the host State and the State of the nationality of the investor, it will give rise to the international responsibility of the host State. But that responsibility will co-exist with the responsibility created in municipal law and each of them will remain valid independently of the other, a situation that further reflects the respective autonomy of the two legal systems (municipal and international) each one with regard to the other.”²⁸

Why do I mention all this? It simply follows from this understanding that in the alternative that the Tribunal in *TECMED v. Mexico* would not have found Mexico’s acts being in violation of substantial BIT provisions, *TECMED* could still have raised the issue that these acts were in violation of the contract. Then, effectively, it would have been necessary to establish that the Tribunal could exercise jurisdiction over contract claims. Since *TECMED* did not raise the contract claim, the Tribunal did not have to deal with this issue.

This example should point out that when it is said that tribunals are *competent to hear contract claims* if a *contract violation amounts to a violation of a BIT*, this is not really true. The tribunal *does not really uphold jurisdiction over the contractual claim*. What it does is to examine whether the alleged acts and omissions of the state constitute a breach of substantial BIT provisions. It is a different question of whether or not a tribunal is competent to hear contractual claims.

It should thus be avoided to state that an international tribunal has jurisdiction over contract claims when the same acts and omissions (e.g. the non-renewal of permits) violate both the contract and the treaty. In other words, the fact that an investor could have raised a contract claim based on the same set of facts as the treaty claim does not mean that the investor has

²⁸ *Noble Ventures*, par. 53.

actually raised a contract claim and it means even less that the tribunal has upheld jurisdiction over this type of claims. This distinction may at first sight seem very formalistic; it will be shown that it is essential for a clear analysis of the umbrella clause.

The Tribunal in *Noble Ventures* also stressed this:

“It may be further added that, inasmuch as a breach of contract at the municipal level creates at the same time the violation of one of the principles existing either in customary international law or in treaty law applicable between the host State and the State of the nationality of the investor, it will give rise to the international responsibility of the host State. But that responsibility will co-exist with the responsibility created in municipal law and each of them will remain valid independently of the other, a situation that further reflects the respective autonomy of the two legal systems (municipal and international) each one with regard to the other.”²⁹

Ad situation 3: jurisdiction over contract claims thanks to an umbrella clause?

The umbrella clause is sometimes said to have the effect of “elevating contract claims to the level of treaty claims”³⁰ or of “transforming contract claims into treaty claims”.³¹ Furthermore, as pointed out above (situation 3), the existence of the umbrella clause is usually seen as one of several circumstances that can make an international tribunal competent to hear contract claims. The following analysis shall demonstrate that neither of these views is covered by the wording of the umbrella clause and that the umbrella clause can thus *by no means have these effects*. What is more, it will be seen that it is not at all necessary to interpret the umbrella clause as an “elevator clause” in order to give it its full effect.

Let us begin with a freely chosen umbrella clause and briefly analyze its wording. Art. 3 (4) of the Belize-Netherlands BIT reads as follows:

“Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals of the other Contracting Party.”³²

²⁹ *Noble Ventures*, par. 53.

³⁰ E.g., *SGS v. Pakistan*, par. 156.

³¹ E.g., *SGS v. Pakistan*, par. 160; *El Paso v. Argentina*, par. 70.

³² BIT available at: http://www.unctad.org/sections/dite/iaa/docs/bits/netherlands_belize.pdf. Page last visited: 11.01.2007.

Let us assume that the term “shall” is imperative and that to “observe” an “obligation” means not to breach them. Let us further assume that the phrase “any obligation [...] entered into with regard to investments” comprises obligations under contracts relating to investments. Given these assumptions, what this provision does is that it creates for either Contracting Party a legal obligation under the BIT to abide by its obligations under state contracts. Therefore, if a Contracting Party breaches provisions of such a contract it violates not only the contract itself but also the BIT or, more precisely, the umbrella clause.

A violation of a contractual provision gives thus rise not only to a contract claim but also – thanks to the umbrella clause – to a treaty claim.

By contrast, the umbrella clause’s wording does *by no means indicate* that it “*elevates*” the *contractual claim to a treaty claim*. This interpretation leads to the erroneous appearance that contract claim and treaty claim become one and that the original contractual claim would disappear. It is not true that the umbrella clause creates a link between the two types of claims. It does however constitute a very close link between violations of a contract and violations of the BIT since any violation of the contract is – by virtue of the umbrella clause – also a violation of the treaty. The contractual claim remains; the umbrella clause simply constitutes for the investor a second legal provision, a BIT provision, he can base a different claim on, a treaty or “umbrella clause” claim.

Therefore, if the claimant alleges that the umbrella clause makes a treaty claim out of a contractual one, the tribunal should decidedly reject this view and hold that the umbrella clause does not “elevate”, “transform” or “turn” contract claims into treaty claims. Indeed, the umbrella clause should be seen as a separate, ordinary BIT standard of protection to which the same rules as to other such standards apply (which were outlined above in “*Ad situation 1: jurisdiction over contract claims – really?*”). Thus, according to this view, where a contract is violated, the investor can raise two different claims: a contract claim *and* a BIT claim.

Ad situation 2: jurisdiction over contract claims

Having sorted out situations 1 and 3, one might ask: can an international tribunal ever be competent to hear contract claims? Opinions are divided. A number of tribunals and also scholars have accepted that under the circumstances described as situation 2 above (namely if the BIT contains a broad dispute settlement clause referring to “any disputes relating to

investments” or just “disputes regarding investments”), the tribunal may exercise jurisdiction over contract claims. Other tribunals have opposed themselves to this view. The matter is not settled and will be subject to further consideration.

In *Salini v. Morocco*, Art. 8 of the applicable BIT offered a choice of three dispute settlement fora for “[a]ll disputes or differences, including disputes related to the amount of expropriation, nationalisation, or similar measures, between a Contracting Party and an investor of the other Contracting Party concerning an investment [...]”. The Tribunal found the terms of Art. 8 “very general” and held that “[t]he reference to expropriation and nationalisation measures [...] cannot be interpreted to exclude a claim based in contract from the scope of application of this Article.”³³ It expressly stated that “Article 8 compels the State to respect the jurisdiction offer in relation to violations of the Bilateral Treaty and any breach of a contract that binds the State directly.”³⁴

The Tribunal in *SGS v. Philippines* had to interpret Art. VIII of the Swiss-Philippine BIT which provided that “disputes with respect to investments” could be referred to international arbitration. Dealing with the question whether the exclusive dispute settlement clause in the state contract could oust its jurisdiction over contract claims it stated: “It is not plausible to suggest that general language in BITs dealing with all investment disputes should be limited because in some investment contracts the parties stipulate exclusively for different dispute settlement arrangements.”³⁵ Therefore the Tribunal concluded that “it was open to SGS to refer the present dispute, as a contractual dispute, to ICSID arbitration under Article VIII(2) of the BIT”³⁶ and thus upheld jurisdiction over contract claims.³⁷

In *SGS v. Pakistan* the dispute settlement clause in the BIT referred to ICSID arbitration “disputes with respect to investments between a Contracting Party and an investor of the other Contracting Party” (Art. 9). The Tribunal held:

“We recognize that disputes arising from claims grounded on alleged violation of the BIT, and disputes arising from claims based wholly on supposed violations of the PSI Agreement, can both be described as “disputes with

³³ *Salini v. Morocco*, par. 59.

³⁴ *Ibid.*, par. 61.

³⁵ *SGS v. Philippines*, par. 134.

³⁶ *Ibid.*, par. 135.

³⁷ Although upholding jurisdiction over contract claims, the Tribunal did not go into the merits of the claims but stayed the proceedings. It drew this consequence from the distinction of the concepts of jurisdiction and admissibility (see par. 136-155, specifically par. 154). This decision was compared with the one in *Vivendi I* and analysed in, e.g., *Schreuer*, *Vivendi I* Case, p. 293f.

respect to investments,” the phrase used in Article 9 of the BIT. That phrase, however, while descriptive of the *factual subject matter* of the disputes, does not relate to the *legal basis* of the claims, or the *cause of action* asserted in the claims. In other words, from that description alone, without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in Article 9.”³⁸

The Tribunal therefore concluded that it had “no jurisdiction with respect to claims submitted by SGS and based on alleged breaches of the PSI Agreement which do not also constitute or amount to breaches of the substantive standards of the BIT.”³⁹

An important argument in this context is that a difference can be struck between dispute resolution provisions in BITs that are broad as the ones just dealt with and others that provide for international arbitration only for “[d]isputes between a national or company of one Contracting Party and the other Contracting Party concerning an *obligation* of the latter *under this Agreement* in relations to an investment of the former”⁴⁰ [Emphases added]. Here the Treaty explicitly limits arbitral tribunals’ jurisdiction to disputes with respect to obligations under the BIT, excluding jurisdiction over claims based on a contract. This argument, used by the Ad hoc Committee in *Vivendi II*, may seem quite strong and plausible. “On the other hand”, as *Gaillard* wrote, “it may seem odd to interpret a treaty as creating a jurisdictional basis for the BIT tribunal in cases where it is not called upon to rule on an alleged violation of that treaty.”⁴¹

As difficult as the answer to the question may seem, if one accepts the view that the umbrella clause does not make a tribunal competent to hear contract claims, but constitutes a regular BIT standard, it becomes irrelevant whether a tribunal upholds jurisdiction over contract claims or not. This is due to the fact that any claim based on the umbrella clause is then a treaty claim and treaty claims normally fall under an international arbitral tribunal’s jurisdiction.

³⁸ *SGS v. Pakistan*, par. 161.

³⁹ *Ibid.*, par. 162.

⁴⁰ Art. 8(1) of the BIT between Angola and the United Kingdom, available at http://www.unctad.org/sections/dite/ia/docs/bits/uk_angola.pdf, last visited 20 January 2007. See also Art. 9 of the Albano-Bulgarian BIT, available at http://www.unctad.org/sections/dite/ia/docs/bits/albania_bulgaria.pdf. These are just some examples; many BITs contain this type of dispute settlement clauses.

⁴¹ *Gaillard*, *SGS Cases*, p. 336.

Part 2 Arguments *pro* & *contra* the umbrella clause's effect – does it have any effect at all?

Even if one accepts that the umbrella clause is an independent BIT standard, this does not set at naught the arguments that respondents and tribunals have raised in support of their limited interpretation of this provision. The question indeed remains of whether the fact that the BIT contains an observance of undertakings clause creates a situation in which any breach by a state of an obligation relating to the investment is a violation of the umbrella clause and thus of the BIT. In every case involving an umbrella clause the respondent has argued that it does not have this effect.

Before we begin to analyze the arguments used in the respective proceedings, it is necessary to make one more important remark: The frequently used statement that under the umbrella clause “violations of the contract become treaty violations”⁴² may lead to the wrong perception that “violations of the contract” are “transformed” into “treaty violations”, meaning that the violation of the contract ceases to exist. This, however, as already mentioned, is not the case. Even if one gives full effect to the umbrella clause in the BIT, the violation of the contract persists and the claimant can at any time (aside a treaty claim based on the umbrella clause) raise a contract claim based on the breach of contract.⁴³ Therefore phrases like “due to the umbrella clause, violations of contract become treaty violations” should be handled with care and could be replaced by the less misleading phrase that, “by virtue of the *pacta sunt servanda* clause, violations of contract amount to breaches of the BIT”. The supporting and opposing arguments that will now be analyzed should therefore be seen as dealing with the latter and not with the former statement.

I Rules on the interpretation of treaties and the interpretation of the umbrella clause

The Tribunal in *SGS v. Pakistan* had to interpret the following umbrella clause:

“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.”⁴⁴

⁴² See footnote 13.

⁴³ Whether the tribunal accepts jurisdiction over the contract claim is, of course, a different matter.

⁴⁴ Art. 11 of the Swiss-Pakistan BIT; see *SGS v. Pakistan*, par. 163.

At first, the Tribunal outlined the interpretative rules it would apply to determine the meaning of this provision:

“We begin, as we commonly do, by examining the words actually used in Article 11 of the BIT, ascribing to them their ordinary meaning in their context and in the light of the object and purpose of Article 11 of the Swiss-Pakistan Treaty and of that Treaty as a whole.”⁴⁵

The Tribunal continued with the analysis of the provision’s wording:

“Firstly, textually, Article 11 falls considerably short of saying what the Claimant asserts it means. The “commitments” the observance of which a Contracting Party is to “constantly guarantee” are not limited to *contractual* commitments. The commitments referred to may be embedded in, *e.g.*, the municipal legislative or administrative or other unilateral measures of a Contracting Party. The phrase “constantly [to] guarantee the observance” of some statutory, administrative or contractual commitment simply does not to our mind, necessarily signal the creation and acceptance of a new international law obligation on the part of the Contracting Party, where clearly there was none before. [...] As a matter of textuality therefore, the scope of Article 11 of the BIT, while consisting in its entirety of only one sentence, appears susceptible of almost indefinite expansion. 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 (widely considered to be a matter of municipal rather than international law) are automatically “elevated” to the level of breaches of international treaty law. Thus, it appears to us that while the Claimant has sought to spell out the consequences or inferences it would draw from Article 11, the Article itself does not set forth those consequences.”⁴⁶

Firstly, it must be mentioned that the Tribunal fails to apply at least one of the interpretative rules it outlines at the very beginning. While it does analyse the “ordinary meaning” of Art. 11, it surely does not take into consideration the “context, object and purpose of the Treaty”. The Tribunal rather raises an argument that is difficult to understand: While admitting that “the scope of Article 11 [...] appears susceptible of almost indefinite

⁴⁵ SGS v. Pakistan, par. 164.

⁴⁶ Ibid., par. 166.

expansion”, it holds that this provision “falls considerably short of saying what the Claimant asserts it means.” Does the fact that a provision may have a scope “susceptible of almost indefinite expansion” imply that it cannot mean what the claimant alleges? To the contrary, as *Schreuer* noted: “The fact that the reference to “commitments” in Article 11 of the Pakistan-Switzerland BIT is not limited to contractual commitments is no reason to exclude contracts from its meaning.”⁴⁷

With respect to the claimant’s assertion that any view of Art. 11 other than that sustained by SGS, would deprive Art. 11 of its *effet utile*⁴⁸, the tribunal found that it was “not persuaded that rejecting SGS’s reading of Article 11 would necessarily reduce that Article to “pure exhortation”, that is, to a non-normative statement”⁴⁹. It gave two possible meanings to the umbrella clause:

“Firstly, [...] [the] confirmation in a treaty that a Contracting Party is bound under and pursuant to a contract, or a statute or other municipal law issuance [...] could, for instance, signal an *implied affirmative commitment to enact implementing rules and regulations* necessary or appropriate to give effect to a contractual or statutory undertaking in favor of investors of another Contracting Party that would otherwise be a dead letter. Secondly, [...] *under exceptional circumstances*, a violation of certain provisions of a State contract with an investor of another State might constitute violation of a treaty provision (like Article 11 of the BIT) enjoining a Contracting Party constantly to guarantee the observance of contracts with investors of another Contracting Party. For instance, if a Contracting Party were to take action that materially impedes the ability of an investor to prosecute its claims before an international arbitration tribunal (having previously agreed to such arbitration in a contract with the investor), or were to refuse to go to such arbitration at all and leave the investor only the option of going before the ordinary courts of the Contracting Party (which actions need not amount to “denial of justice”), that Contracting Party may arguably be regarded as having failed “constantly [to] guarantee the

⁴⁷ *Schreuer*, Travelling the BIT Route, p. 253.

⁴⁸ For more detail on this issue see *Daillier, Pellet*, Droit International Public, p. 263 f.

⁴⁹ *SGS v. Pakistan*, par. 172.

observance of [its] commitments” within the meaning of Article 11 of the Swiss-Pakistan BIT”⁵⁰. [Emphases added]

Referring to this part of the *SGS v. Pakistan* decision, the Tribunal in *SGS v. Philippines* accurately noted that “the Tribunal failed to give any clear meaning to the “umbrella clause””⁵¹. This interpretation is indeed anything but clear and raises a number of questions: What is an “implied affirmative commitment to enact implementing rules and regulations”? Would the host state be in breach of the umbrella clause if it failed to take legislative measures favorable to the investment? If so, what kind of measures would be sufficient for a state to abide by its obligation under this provision? Is it practical to see a violation of the umbrella clause if the host state fails to implement rules and regulations without causing, with its reluctant behavior, any material damage to the investor? Further, with respect to the Tribunal’s second approach: under what “exceptional circumstances” other than that outlined by the Tribunal would the *pacta sunt servanda* clause be violated? The Tribunal does not characterize these “exceptional circumstances” but would leave it to future tribunals to determine themselves whether or not the circumstances are “exceptional” or not. This would add extreme legal uncertainty every time such a clause is at issue. What is more, it can be doubted that the two interpretations given by the Tribunal accord the umbrella clause much, if any, *effet utile*. As will be seen, the plain meaning of the words on its own indicates a much broader effect.

One of the Tribunals that came to a highly distinct result when interpreting the observance of undertakings clause was the one constituted in *Eureko v. Poland*. Here, the Tribunal analyzed Art. 3.5 of the Dutch-Polish BIT which provides that each Contracting Party “shall observe any obligations it may have entered into with regard to investments of investors of the other Contracting Party”⁵². It pointed out that this provision was a rule of public international law which needed to be interpreted in accordance with the Vienna Convention^{53 54}.

“Article 31, paragraph 1, of that Convention provides that: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and

⁵⁰ *Ibid.*

⁵¹ *SGS v. Philippines*, par. 125.

⁵² *Eureko v. Poland*, par. 244.

⁵³ Vienna Convention on the Law of Treaties, 1969, available at http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf, last visited 22 January 2007.

⁵⁴ *Eureko v. Poland*, par. 247; similarly in *Noble Ventures*, par. 50.

purpose.”⁵⁵ “[T]he “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 regard to investments of investors of the other Contracting Party.”⁵⁶ “The context of Article 3.5 is a Treaty whose object and purpose is “the encouragement and reciprocal protection of investment”, a treaty which contains specific provisions designed to accomplish that end, of which Article 3.5 is one. [...] It is [...] well established [...] that treaties, and hence their clauses, are to be interpreted so as to render them effective rather than ineffective.”⁵⁷ “Thus, insofar as the Government of Poland has entered into obligations vis-à-vis Eureko with regard to the latter’s investment, and insofar as the Tribunal has found that the Respondent has acted in breach of those obligations, it stands [...] in violation of Article 3.5 of the Treaty.”⁵⁸

The reasoning of the Tribunal is more than conclusive: the ordinary meaning of the words is clear; approving its correctness, the result obtained from this literal interpretation is absolutely conform with the object and purpose of the treaty; furthermore, the literal interpretation gives to the clause the *effet utile* required. All these points taken together can only lead to the result that violations of a contract simultaneously violate Art. 3.5 of the BIT.

II The umbrella clause as a provision “susceptible of almost indefinite expansion”

In par. 166 of its decision, the Tribunal in *SGS v. Pakistan* implicitly raises the argument that a narrow interpretation is necessary because SGS’s view of the umbrella clause would make the provision “susceptible of almost indefinite expansion.”⁵⁹

Of course, this is not a legal argument and the mere fact that a provision in a BIT has far-reaching consequences cannot be used as a justification for its narrow interpretation. This is even truer if one considers that states should be and often are well aware of the potential

⁵⁵ *Ibid.*, par. 247.

⁵⁶ *Ibid.*, par. 246.

⁵⁷ *Ibid.*, par. 248.

⁵⁸ *Ibid.*, par. 244.

⁵⁹ *SGS v. Pakistan*, par. 166; see also *El Paso v. Argentina*, par. 72.

effects of the BIT provisions they agree upon. At least one prominent example shows that this was the case:

After the decision rendered in *SGS v. Pakistan*, the Swiss Government addressed a letter to ICSID stressing that it was “alarmed about the very narrow interpretation given to the meaning of [the umbrella clause] 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”.⁶⁰

Indeed, and this applies to all states and all BIT provisions, would the parties to a treaty want to confer upon the respective investors a lower level of protection, they would stipulate the clauses of the BIT differently.

III The umbrella clause as an exception from the general rule; no evidence for the intent of the Contracting Parties

In its decision, the Tribunal constituted in *SGS v. Pakistan* explained that the umbrella clause, as an exception to the general rule that a violation by a state of a contract with an alien does not, by itself, constitute a violation of international law, had to be interpreted restrictively unless clear evidence proved that the Contracting Parties had intended to give to the clause the far-reaching effect alleged by Claimant. It held:

“Considering the widely accepted principle with which we started, namely, that under general international law, a violation of a contract entered into by a State with an investor of another State, is not, by itself, a violation of international law, law, and considering further that the legal consequences that the Claimant would have us attribute to Article 11 of the BIT are so far-reaching in scope, [...] we believe that clear and convincing evidence must be adduced by the Claimant [...] that such was indeed the shared intent of the Contracting Parties to the Swiss-Pakistan Investment Protection Treaty in incorporating Article 11 in the BIT. We do not find such evidence in the text itself of Article 11. We

⁶⁰ Note attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy-Secretariat General dated 1 October 2003, published in 19 Mealey’s International Arbitration Reports (February 2004).

have not been pointed to any other evidence of the putative common intent of the Contracting Parties by the Claimant.”⁶¹

First of all it must be noted that, if the effect of the umbrella clause really is that any breach of a contract amounts, at the same time, to a breach of international law, this would indeed constitute an exception from the general rule outlined above. The question therefore is whether the exception to a rule must really be interpreted in a restrictive way. If this can be considered a rule of interpretation, the argument is indeed valid. At the same time it must be clear that a “restrictive interpretation” may not be so restrictive as to render the exception null and void – in other words even the restrictive interpretation must leave to the clause a meaningful scope of application.

However, the Tribunal showed no evidence that, as a rule of international law, exceptions from general international law principles had to be interpreted in a restrictive way. In addition, this view would lead to outright conflict with the results obtained when applying the interpretative rules outlined above – rules which are widely accepted rules of customary and treaty law.

These rules that, as we have seen, outline the predominant importance of the ordinary meaning of the words used by the parties, would be set at naught. In addition, it would be totally impractical would the contracting parties to a treaty always have to add “clear evidence” that they mean what they say when stipulating, in very clear terms, exceptions from a general rule that have far-reaching consequences. Just to illustrate this: Until the signature of the Kellogg-Briand Pact⁶² in 1928 it was an established rule of international law that the use of force was a legitimate means of policy. Would anyone have dared to say that, in order to make the treaty legally binding, the parties to it would have had to show “clear evidence” that what they intended was indeed the renunciation of the use of force in international relations?⁶³

⁶¹ *SGS v. Pakistan*, par. 167; see also *El Paso v. Argentina*, par. 77.

⁶² Full title: „Treaty between the United States and other Powers providing for the renunciation of war as an instrument of national policy“, signed in Paris, 27 August 1928. Available in English and French in *Bruns*, Politische Verträge.

⁶³ For a statement underlining that this treaty created an entirely new legal situation, see *Roscher*, Briand-Kellogg-Pakt, 281.

IV Other substantial BIT standards would be rendered superfluous

One of the arguments that are usually raised when it comes to the interpretation of the umbrella clause is that a wide interpretation of the latter would render all the other current standards of treatment, “substantially superfluous”⁶⁴. The Tribunal in *SGS v. Pakistan* held:

“There would be no real need to demonstrate a violation of those substantive treaty standards if a simple breach of contract, or of municipal statute or regulation, by itself, would suffice to constitute a treaty violation on the part of a Contracting Party and engage the international responsibility of the Party.”⁶⁵.

Schreuer, commenting on this decision, found it was “not clear why the acceptance of the umbrella clause as covering breaches of contract would have made the BIT’s substantive provisions superfluous. The BIT’s substantive provisions deal with non-discrimination, fair and equitable treatment, national treatment, MFN treatment, free transfer of payments and protection from expropriation. These issues are not normally covered in contracts. Therefore, extending the BIT’s protection to investment contracts would not make the substance of a BIT superfluous.”⁶⁶

The Tribunal in *El Paso v. Argentina*, by contrast, argued in favor of the narrow interpretation given in *SGS v. Pakistan* and stressed in a very descriptive way that

“the interpretation given in *SGS v. Philippines* [...] renders the whole Treaty completely useless : indeed, if this interpretation were to be followed – the violation of *any legal obligation* of a State, and not only of any contractual obligation with respect to investment, is a violation of the BIT, whatever the source of the obligation and whatever the seriousness of the breach – it would be sufficient to include a so-called “umbrella clause” and a dispute settlement mechanism, and no other articles setting standards for the protection of foreign investments in any BIT. If any violation of any legal obligation of a State is *ipso facto* a violation of the treaty, then that violation needs not amount to a

⁶⁴ *SGS v. Pakistan*, par. 168.

⁶⁵ *Ibid.*

⁶⁶ *Schreuer*, *Travelling the BIT Route*, p. 152; this statement was also cited by the Tribunal in *Eureko v. Poland*, par. 258.

violation of the high standards of the treaty of “fair and equitable treatment” or “full protection and security”.⁶⁷

These conflicting views have not yet been analyzed. Would an extensive interpretation of the *pacta sunt servanda* clause really render the rest of the treaty’s protective standards useless? If so, would this necessarily impose a narrow interpretation of the umbrella clause? In other words, is it an established rule of the international law on the interpretation of treaties that, if one of several treaty provisions, literally interpreted, entirely fulfils the function of a number of other treaty provisions, the former must be narrowly interpreted in order to leave for the latter a significant scope of application?

With reference to the first question it can be said that evidently, the degree to which the umbrella clause might have the effect of rendering large parts of a BIT obsolete is heavily dependent on the scope of obligations that are covered by an observance of commitments provision. Although Part 3 deals with this issue in more detail, it shall be noted here that, first of all, umbrella clauses are not uniformly drafted and that therefore different umbrella clauses might lead to different conclusions. Secondly, case law dealing with the question of what obligations exactly are covered by the umbrella clause, has just begun to develop. While most tribunals so far held that the wording “obligations entered into with respect to investments” referred to “specific commitments” and that thus, the umbrella clause would only be triggered if specific – and not general – commitments were violated, their decisions differed in as far as they found different scopes of obligations to be “specific”. While the Tribunal in *SGS v. Philippines* considered that “collateral guarantees, warranties or letters of comfort”⁶⁸ were “specific”, the Tribunal in *LG&E v. Argentina* admitted that this applied even to provisions of a host state’s Gas Law.⁶⁹ No Tribunal has so far accepted that “obligations” under municipal law are covered by an umbrella clause.⁷⁰ Such a broad view could indeed have the consequence that a number of protective BIT standards could be deprived of at least some of their importance. However, as noted in Part 3, it is doubtful whether provisions in a state’s municipal law can be referred to as “commitments” and thus, whether they can really be covered by the umbrella clause.

⁶⁷ *El Paso v. Argentina*, par. 76; see also *Pan American v. Argentina*, par. 105.

⁶⁸ *SGS v. Philippines*, par. 117.

⁶⁹ *LG&E v. Argentina*, par. 174; for more detail see Part 3, sub-chapter “Scope of obligations covered by umbrella clauses”.

⁷⁰ All tribunals that noted that the umbrella clause’s wording was – in principle – susceptible of applying also to this kind of obligations, in the end interpreted the umbrella clause in an extremely restrictive way; see, e.g., *SGS v. Pakistan*, *El Paso v. Argentina*, *Pan American v. Argentina*.

Still, for the sake of the argument, let us consider that the umbrella clause has the broadest thinkable scope of application, including “obligations” under domestic law. Even this would not render the entire rest of treatment standards unnecessary. On the one hand, as we will see, there are BIT standards dealing with issues that are neither covered by state contracts nor by municipal law and can thus neither be covered by the umbrella clause (which covers obligations under contracts and municipal law). On the other hand, even with respect to standards of treatment that cover areas in which the state also has obligations under a contract or under its municipal law and thus also under the umbrella clause – i.e., primarily, the standard of full protection and security and the standard of fair & equitable treatment – one can think of cases in which the umbrella clause would not be operative.

Let us first consider the current BIT standard of “national treatment”. In strongly simplified terms this relative standard obliges the host state to treat investors at least as favorably as its own nationals. Normally neither a state contract nor the host state’s municipal law contains a legal commitment to grant foreigners such treatment. Thus, since there is no obligation at all which it could cover, the umbrella clause can be no means become operative. The “national treatment” standard can thus not be replaced by an umbrella clause. The same applies to the MFN clause although here domestic laws will more frequently provide for equal treatment of foreigners. In the latter case (still admitting that the umbrella clause applies to “obligations” under the municipal law) a differential treatment of foreigners with distinct nationality would not only be a breach of the MFN clause but also a breach of the umbrella clause.

With respect to the standard of “full protection and security”, let us consider the following hypothetical example: The host state’s ministry of defense tests new rockets. By accident one of the rockets crashes into and destroys a factory which constitutes the core of an investor’s investment. At first sight, such an act may constitute a violation of the BIT standard of “full protection and security”. At the same time, however, under the host state’s domestic civil law (or under a state contract – but this will rarely be the case!), these facts might give rise to the *obligation* of the host state *to pay compensation for the damage caused*. This being an obligation under municipal law and the umbrella clause covering such obligations, the result would be that the non-payment of the damages due under municipal law would constitute, at the same time, a violation of this provision.

In this case the umbrella clause would indeed be – in addition to the “full protection and security” standard – a second legal basis for a BIT claim. But what if such an accident

happened in a state with no elaborate civil law system in force? If municipal law does not impose the duty to compensate damage, the umbrella clause has no effect and the “full protection and security” clause would again be essential for the investor. In short, one can think of situations in which even the broadest interpretation of the umbrella clause would not make other BIT provisions useless.

To sum up, it will hold true for many cases that the acts and omissions of a state which are in violation of a protective BIT standard will as well constitute a breach of the *pacta sunt servanda* clause. However, laws and contracts do not prohibit all those behaviors that constitute violations of substantive BIT standards other than the umbrella clause. Therefore, not *every* set of facts that gives rise to a claim based on one of the most current BIT standards necessarily constitutes at the same time a breach of the umbrella clause. Whether both an ordinary BIT standard and the umbrella clause, one or even none of them is violated will entirely depend on the circumstances of the case. It is thus justified to include in a BIT both the common protective standards and the umbrella clause without having to interpret the latter in a narrow way whatsoever.

Having answered the first of the two questions posed at the outset of this sub-chapter by the negative, the second one becomes somewhat obsolete. However, for the sake of completeness, a few words shall be added with respect to the second question which concerns the rules of treaty interpretation. Due to the established rule that has already been mentioned, namely that treaty provisions are to be interpreted in a way that renders them effective rather than ineffective, it is probably also true that if one treaty provision, literally interpreted, would render useless other treaty provisions, the former must be narrowly interpreted in order to give the latter some *effet utile*. The parties to the treaty can simply not be deemed to have established legal rules without any content. However, as has been described, it is not necessary to interpret the umbrella clause in an excessively narrow way in order to render other BIT provisions effective. For the Tribunal in *El Paso v. Argentina*, convinced that a broad interpretation of the umbrella clause turned other BIT provision into empty phrases, e.g., it would have been sufficient to limit the scope of application of the umbrella clause to obligations contained in state contracts, excluding “obligations” under municipal law.⁷¹ As outlined above, this would leave a very broad field of application for other BIT standards. By contrast, what it did was to deprive the disputed provision even of

⁷¹ As will be outlined in Part 3, the view that umbrella clauses do not apply to “obligations” under municipal law is likely to be correct since the municipal law as such will seldom be an “obligation”.

the core of its scope of application: contractual obligations. It may be doubted whether this interpretation of the umbrella clause is consistent with the rule of *effet utile*.

V The existence of an exclusive dispute settlement clause in a state contract

The Tribunal in *SGS v. Pakistan* brought forward another argument for a narrow interpretation of the umbrella clause. In this case, the Tribunal was confronted with a BIT containing an umbrella clause and a state contract between SGS and Pakistan which provided for dispute settlement under the Arbitration Act of Pakistan: “Any dispute [...] relating to this Agreement [...] shall be settled by arbitration in accordance with the Arbitration Act of the Territory as presently in force.”⁷². The Tribunal stated that one of the reasons why the umbrella clause needed to be interpreted in a restrictive way was SGS’s allegation that “the PSI Agreement procedure must give way to the ICSID procedure contemplated in the BIT [...] because the contract claims are transformed into BIT claims by the operation of Article 11 of the BIT”⁷³. The Tribunal followed the claimant’s allegation in as far as it held that “[a] [...] consequence [of a broad interpretation of the umbrella clause] would be that an investor may, at will, nullify any freely negotiated dispute settlement clause in a State contract”⁷⁴. It therefore gave the umbrella clause the very narrow and somewhat vague meaning already outlined in detail above.

The view adopted by both Claimant and the Tribunal in this case was based on the assumption that a broad interpretation the umbrella clause gave it the effect of elevating the contract claims to the level of treaty claims. As a consequence it would not be for the arbitrator under the Pre-Shipment-Inspection Agreement but for the ICSID Tribunal to determine whether or not the contract claim was well-founded. The dispute settlement clause in the contract would thus be an empty phrase. *Rajski*, one of the arbitrators in *Eureko v. Poland*, added a dissenting opinion to this award in which he raised the same concerns:

⁷² Art. 11 of the PSI Agreement; for the full wording see *SGS v. Pakistan*, par. 15.

⁷³ *SGS v. Pakistan*, par. 160.

⁷⁴ *Ibid.*, par. 168.

“This way, jurisdiction clauses agreed by the parties submitting all contractual disputes between the parties to an international arbitration tribunal or a state court may be easily frustrated by a foreign contracting party.”⁷⁵

As emphasized at the very beginning (Part 1), the view that the umbrella clause “transforms” contract claims into treaty claims should be thought over because it is by no means covered by the clause’s wording and leads to overwhelming confusion. One of the consequences of this misleading theory would be that once the “transformation” has taken place, the contractual claim would “disappear” and be replaced by the treaty claim. If this was the case, the dispute settlement clause in the state contract would indeed be deprived of its meaning. However, if one accepts that the umbrella clause is an independent BIT standard, the solution to this pretended paradox is quite simple:

In absence of an umbrella clause, a breach of a contract would give rise to a contract claim exclusively. If the BIT does contain an umbrella clause, the breach of the contract constitutes a violation of this clause and thus gives rise to a BIT claim. But it gives rise to the BIT claim – and this is the crucial point – without annulling the contract claim! In other words, thus, every time a BIT contains an observance of commitments clause, a contract violation gives rise to two independent claims: a contract claim based on the contract violation and a BIT claim based on the violation of the umbrella clause.

It should be noted that this legal situation is by no means exceptional. On the contrary, as every lawyer knows, very frequently one single act gives rise to a number of claims based on different legal grounds. In our case the act is the breach of a contractual obligation; the different legal grounds are the contractual one on the one hand and the umbrella clause on the other hand.

By accepting that the contract violation entails two independent claims, the problem described above disappears: while the ICSID arbitrator has jurisdiction over the BIT claim (the umbrella clause claim), the contract arbitrator is not at all deprived of his jurisdiction over the contract claim – at least not as a result of the broad interpretation of the umbrella clause. In fact it would still be worth to discuss whether the ICSID Tribunal does also have

⁷⁵*Eureko v. Poland*: Professor Jerzy Rajski’s Dissenting Opinion, par. 11; the dissenting opinion is attached to the award.

jurisdiction over the contract claim. But this is a different question that is not related to the umbrella clause.⁷⁶

Of course, one might object, accepting that international investment tribunals have jurisdiction over umbrella clause claims, leads to the following unsatisfactory situation: In order to determine whether the umbrella clause has been breached, the tribunal needs to analyze whether the contract has been breached (because only the breach of a contract leads to a breach of the umbrella clause!), and it will do so in applying the law of the host state⁷⁷. If the tribunal comes to the conclusion that the host state has failed to abide by its contractual obligations, it will find a breach of the contract and thus a breach of the umbrella clause. Simultaneously, the claimant might initiate proceedings before the dispute settlement forum provided for in the contract and raise the contract claim. In these proceedings, the judge/arbitrator might find that no violation of contractual obligations has taken place and dismiss the claim. As a result there would be two conflicting awards on one and the same question whether or not the contract has been violated.

It is clear that conflicting dispute settlement outcomes are undesirable. It would however be no solution to interpret a BIT clause in a way inconsistent with its wording in order to prevent conflicting awards and decisions. To the contrary: this problem appears under a great variety of circumstances and can probably – if at all – be resolved only on a broad, multilateral basis.⁷⁸

VI Location of the umbrella clause in the BIT

Tribunals have frequently made reference to the location of the umbrella clause in the respective BIT and gave this criterion at least some importance. In *SGS v. Pakistan*, the umbrella clause was placed not among protective standards of treatment but between dispute settlement and final provisions. The Tribunal held:

“Given the above structure and sequence of the rest of the Treaty, we consider that, had Switzerland and Pakistan intended Article 11 to embody a substantive “first order” standard obligation, they would logically have placed Article 11

⁷⁶ This was already emphasized in Part 1 above: see “Situation 2” and “Ad Situation 2”.

⁷⁷ According to Article 42 (1) of the ICSID Convention, in absence of agreement as to the applicable law, “the Tribunal shall apply the law of the Contracting State party to the dispute [...] and such rules of international law as may be applicable”. Article 42 (1) refers to the domestic law of the host state. It seems very consistent that this question should be decided on the basis of the host state’s municipal law. See also *SGS v. Philippines*, par. 126 and 128.

⁷⁸

among the substantive “first order” obligations set out in Articles 3 to 7. The separation of Article 11 from those obligations by the subrogation article and the two dispute settlement provisions (Articles 9 and 10), indicates to our mind that Article 11 was *not* meant to project a substantive obligation like those set out in Articles 3 to 7 [...].”⁷⁹

The Tribunal in *SGS v. Philippines* commented on this reference made to the umbrella clause’s placement in the BIT:

“[T]he Tribunal in *SGS v. Pakistan* found support for its conclusion in the fact that Article 11 is located at the end of the BIT, after the basic jurisdictional clauses, whereas if it had been intended to impose substantive international obligations it would more naturally have appeared earlier. *This factor is entitled to some weight*, and it is the case that where it appears (as it does in only a minority of BITs) the “umbrella” clause is usually located earlier in the text. *But the Tribunal does not regard the location of the provision as decisive*, having regard to the other considerations recited above. In particular, 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.”⁸⁰ [Emphases added and footnotes omitted]

Also *Schreuer*, referring to the *SGS v. Pakistan* decision, noted that “[t]he argument based on the location of the clause in the BIT is a legitimate supporting argument in the Treaty’s interpretation”. However, it “cannot be extended to other BITs containing similar clauses” in which they “are frequently grouped together with the standards of treatment guaranteed by these treaties.”⁸¹

The Tribunal in *Eureko v. Poland* also briefly addressed the issue:

“Insofar as the placement of the umbrella clause in the BIT – among the substantive obligations or with the final clauses – is of any significance (*in this Tribunal’s view, little*), it should be noted that Article 3.5 of the BIT between

⁷⁹ *SGS v. Pakistan*, par. 170.

⁸⁰ *SGS v. Philippines*, par. 124.

⁸¹ *Schreuer*, *Travelling the BIT Route*, p. 253.

the Netherlands and Poland places its umbrella clause amidst the rendering of the Parties' substantive obligations."⁸² [Emphasis added]

To sum up these statements, the placement of the umbrella clause in the BIT can be used as a legitimate argument. However, this argument should not be accorded too much weight. Under no circumstances should it be considered as decisive.

Part 3 Different wordings – different scopes? How far do the umbrella clause's effects go?

The discussion in Part 2 strongly indicates that the violation of obligations concerning investments may lead to a host state's international responsibility under the umbrella clause. A question that is yet to be answered, however, is what kind of obligations this provision exactly applies to. In this respect, the wordings of umbrella clauses are not uniform. While some speak of "any obligation" others refer to "specific commitments"; while in some cases these obligations may concern "investments" in general, other clauses speak of "specific investments". Do these differing wordings have any practical effects? If so, what are these effects?

I Scope of obligations covered by umbrella clauses

As already mentioned, tribunals and scholars have analyzed umbrella clauses formulated in varying terms. And indeed, as a result, their decisions and analyses were not uniform. Depending on how broadly the clause was formulated, different observance of commitments clauses were found to cover different types of obligations, thus to have different scopes of application. We begin with a rather narrowly drafted umbrella clause and will finish with more broadly formulated ones.

Dr. F. A. Mann commented on an observance of commitments clause which provides that each party "shall observe any obligation arising from a *particular commitment* it may have entered into with regard to a *specific investment*."⁸³ He described it as "a provision of particular importance in that it protects the investor against any interference with his *contractual rights*"⁸⁴. He stated furthermore that this clause comes into play if "the State has entered into a *particular commitment which imposes obligations*. Such obligations may

⁸² *Eureko v. Poland*, par. 259.

⁸³ *Mann*, *British Investment Treaties*, p. 245.

⁸⁴ *Ibid.*, p. 246.

arise *from contract* with the State or *from* the terms of the *licence* granted by it.” He concluded that “[t]hus if the *law of the land* provides that the State is liable for the torts of its servants this is not an ‘obligation arising from a *particular commitment*’ the State may have entered into”.⁸⁵ [Emphases added]

Mann clearly distinguishes between *general commitments* (which do not apply exclusively to the *specific investment*: e.g., obligations under the state’s tort law) on the one hand and *particular commitments* (which apply to the *specific investment* only: e.g., obligations under contracts or licenses) on the other hand and holds that only the latter are covered by the umbrella clause. This is consistent with the clause’s wording. Thus, neither general commitments concerning investments in general, nor general commitments concerning specific investments are covered by this umbrella clause.

In *SGS v. Philippines*, the applicable umbrella clause provided that “[e]ach Contracting Party shall observe *any obligation* it has assumed *with regard to specific investments* in its territory by investors of the other Contracting Party.”⁸⁶ [Emphasis added] This clause is already a little bit wider, since it is not limited to “particular commitments” but applies to “any obligation”.

“[I]t will often be the case that a host State assumes *obligations with regard to specific investments* at the time of entry, including investments entered into on the basis of *contracts* with separate entities. Whether *collateral guarantees, warranties* or *letters of comfort* given by a host State to induce the entry of foreign investments are binding or not, i.e. whether they constitute genuine obligations or mere advertisements, will be a matter for determination under the applicable law, normally the law of the host State. But if *commitments* made by the State *towards specific investments* do involve binding obligations or commitments under the applicable law, it seems entirely consistent with the object and purpose of the BIT to hold that they are incorporated and brought within the framework of the BIT by Article X(2).”⁸⁷ [Emphases added]

Just as *Mann*, the Tribunal explicitly excluded that the umbrella clause could apply to *general obligations*:

⁸⁵ *Ibid.*

⁸⁶ *SGS v. Philippines*, par. 115.

⁸⁷ *Ibid.*, par. 117.

„It is true that Article X(2) of the Swiss-Philippines BIT [...] is not limited to contractual obligations. But it is limited to “obligations... assumed *with regard to specific investments*”. For Article X(2) to be applicable, the host State must have assumed a legal obligation, and it must have been assumed *vis-à-vis the specific investment—not as a matter of the application of some legal obligation of a general character*. This is very far from elevating to the international level all “the municipal legislative or administrative or other unilateral measures of a Contracting Party.””⁸⁸. [Emphases added]

It is important to note that although the wording itself did not speak of “specific” or “particular obligations”, the Tribunal derived from the terms “with regard to specific investment” that “general obligations” could not be meant to be covered.

In *Noble Ventures*, the Tribunal interpreted the broad provision of Art. II (2)(c) of the US-Romanian BIT which speaks of “any obligation [a party] may have *entered into* with regard to *investments*”⁸⁹. It found that “[i]t is difficult not to regard this as a clear reference to investment contracts. In fact, one may ask what other obligations can the parties have had in mind as having been “entered into” by a host State with regard to an investment. The employment of the notion “entered into” indicates that specific commitments are referred to and not general commitments, for example by way of legislative acts. This is also the reason why Art. II (2)(c) would be very much an empty base unless understood as referring to contracts.”⁹⁰

What is interesting in this context is that, although the wording of the *pacta sunt servanda* clause does not explicitly limit its scope of application to “specific commitments”, the Tribunal derived from the notion “entered into” that only “specific commitments” were referred to and thus came to the same result as the two interpreters above.

The Tribunal however expressed doubts “as to whether [...] Art. II(2)(c) of the BIT perfectly assimilates to [the] breach of the BIT *any* breach by the host State of *any* contractual obligation as determined by its municipal law *or* whether the expression “any obligation”, despite its apparent breadth, must be understood to be subject to some

⁸⁸ *Ibid.*, par. 121.

⁸⁹ *Noble Ventures*, par. 51.

⁹⁰ *Ibid.*

limitation in the light of the nature and objects of the BIT.”⁹¹ Thus, in the Tribunal’s view, *some specific obligations* could possibly be outside the umbrella clause’s scope.

LG&E v. Argentina was the first case in which a tribunal explicitly accepted that obligations arising immediately from the host state’s municipal law fall under the protection of the umbrella clause. Under its Gas Law and a corresponding regulation, Argentina had fixed and regulated the tariff scheme ensuring the value of LG&E’s investment. More precisely, it had guaranteed the calculation of the tariffs in dollars before conversion to pesos, a semi-annual tariff adjustment by the producer price index and no price controls without indemnification. During the economic crisis, Argentina amended its Gas Law and the regulation with the consequence that LG&E could no more benefit from these explicit guarantees. The broadly termed Art. II(2)(c) of the relevant BIT provided that “[e]ach party shall observe any obligation it may have entered into with regard to investments.”⁹²

The Tribunal held that “[s]uch [a] clause [...] creates a requirement for the host State to meet its *obligations* towards foreign investors, including those *that derive from a contract*.”⁹³ Assuming that only specific obligation were covered by the umbrella clause⁹⁴ and referring to the Gas Law and the regulation it found “that these provisions were *not legal obligations of a general nature*. On the contrary, they were *very specific* in relation to LG&E’s investment in Argentina, so that their abrogation [was] a violation of the umbrella clause.”⁹⁵ [Emphases added]

By this reasoning, the Tribunal accorded the umbrella clause a function very similar to that of so-called “stabilization clauses”. Stabilization clauses are provisions that are often contained in state contracts and stipulate that adverse changes in the host state’s legislation will not apply to the investor’s investment. There is, however, a slight difference between the consequences the Tribunal drew from the umbrella clause and the consequences that are drawn from a stabilization clause. The latter is not violated when the law is changed – the stabilization clause does not limit the state’s sovereignty in this respect. It is violated only if adverse changes in the legislation effectively apply to the investment. According to the

⁹¹ *Ibid.*, par. 61.

⁹² *LG&E v. Argentina*, par. 169.

⁹³ *Ibid.*, par. 170.

⁹⁴ See footnote 50 in *LG&E v. Argentina*, at par. 174.

⁹⁵ *Ibid.*, par. 174, footnote omitted.

Tribunal in *LG&E v. Argentina*, however, the mere “abrogation” of the Law and of the regulation was “a violation of the umbrella clause”.

It may be doubted whether this view is consistent with the umbrella clause’s wording. This provision renders wrongful violations of *obligations*. Can a law as such constitute an obligation of the state towards the investor? According to the decision, the obligation consisted in the duty not to amend the law although this obligation was nowhere expressly stated – neither in a contract nor in the law itself. It may even be doubted whether the simple non-application of the laws in force (if the laws would not have been amended but simply not applied with regard to the investor) would have amounted to a breach of the umbrella clause since the laws nowhere stipulated expressly the obligation that they had to be applied with respect to the investor. The situation may be different where a law expressly holds that it must be applied or must not be amended with respect to the investor or if a contract stipulates such obligations. In these cases, an abrogation or a non-application of the relevant laws and regulations could amount to breaches of the respective legal or contractual provision and thus of the umbrella clause. However, it is difficult to see in a law itself not containing such explicit obligations an “obligation entered into with regard to investments”.

Coming back to the umbrella clause’s wording, again, it is worth to note that, although the umbrella clause in *LG&E v. Argentina* was held in very general terms, the Tribunal limited its scope of application to “specific obligations”, excluding “legal obligations of a general nature”. The authority arising from these cases is that, no matter how generally an umbrella clause is termed, it is only triggered if the obligations breached are specific ones, i.e., if they concern particularly the investment in question. It is interesting to observe that, despite the differing wordings tribunals tend to interpret umbrella clauses at least somewhat similarly. This is not stringent. Tribunals could indeed develop different interpretations for different wordings and develop different bodies of case law for every single type of umbrella clause.

II Scope of violations of obligations covered

Clearly, if an obligation is not under the scope of the observance of commitments provision, no violation – as intense as it may be – of this obligation will trigger the state’s international responsibility under this clause. On the other hand, does the fact that a commitment is covered by itself necessarily mean that *any violation* of it will be in breach

of the umbrella clause? The wording “shall observe” does not seem to offer a great number of varying interpretations. It indicates, at first sight, that *any violation* of the covered obligations would be in breach of the umbrella clause. While case law has yet to address this issue, some scholars have commented on the question of what kind of violations go far enough as to trigger the umbrella clause’s protection.

Mann imposed no restrictions on the violations covered by the umbrella clause. In his opinion this provision’s effect was to render wrongful “*any interference* with [the investor’s] contractual rights, whether it results from a *mere breach of contract* or a *legislative or administrative act* [...]”. The violation could be the effect of, e.g., “[t]he variation of the terms of a contract or licence 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 [...]”.⁹⁶

The Tribunal in *Eureko v. Poland* cited *R. Dolzer* and *M. Stevens* who similarly stated that “[this] provision [...] 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...”.⁹⁷

While nobody has yet argued that only specific kinds of violations are covered by the umbrella clause, it is possible that sooner or later somebody will raise this argument. In that case it would be of great importance to distinguish between the two independent features of what kind of obligations are covered by the observance of undertakings clause, on the one hand, and of what kind of violations of these obligations are covered by it, on the other hand.

⁹⁶ *Mann*, *British Investment Treaties*, p. 246.

⁹⁷ *Eureko v. Poland*, par. 251.

Conclusions

A number of conclusions can be drawn from the above considerations. Firstly, it should be held that the observance of undertakings provision should not be deemed to “elevate contract claims” to the level of “treaty claims”. The question of what the umbrella clause’s effect is should be strictly detached from the question of whether or not an international arbitral tribunal may exercise jurisdiction over contract claims. In fact, the two issues do not – as most tribunals have so far assumed – relate to each other. The umbrella clause should be seen as a provision which creates for the investor an additional legal basis for a claim: the umbrella clause claim. This umbrella clause claim is coexistent – and not identical! – with the contract claim. These are the clear results of an analysis of the typical umbrella clause’s wording.

Secondly, the considerations made with respect to the arguments *pro* and *contra* a wide interpretation of the sanctity of contract clause has shown that very few – if any – of the arguments against a broad interpretation are well-founded. The “ordinary meaning” that is “to be given to the terms of the treaty” clearly accords the umbrella clause a far-reaching effect; the “object and purpose” of BITs being the encouragement and protection of investments underlines that the correctness of this literal interpretation; the necessity to interpret every provision of a treaty so as to accord it *effet utile* prohibits an interpretation that would render the clause an empty phrase. It should thus definitely be accepted that the umbrella clause means what it says.

Thirdly and lastly, it must be noted that, of course, the analysis of the different scopes of obligations covered by differently drafted observance of commitments clauses is by no means exhaustive. Not only is there today an enormous variety of umbrella clauses that have yet to be interpreted by tribunals. Evidently, the interpretations outlined in Part 3 cannot be applied to, e.g., a clause providing that “Each Contracting Party shall observe any *contractual* obligation which it may have entered into [...]”⁹⁸, this clause being significantly narrower than those analysed above. But also with respect to the already analyzed – “wider” – sanctity of contract clauses, a large number of questions wait to be resolved by future tribunals: What exactly is a “specific obligation”? Does it need to concern the “particular investment only” or may it concern “investments in general” without losing its “specificity”? Does the term “enter into” really indicate that only

⁹⁸ Art. 7 of the BIT between Austria and Cape Verde

“specific commitments” concerning “specific investments” are covered or might future tribunals come to the conclusion that the terms “any obligation entered into” may concern also “any legal obligation under municipal law”⁹⁹, thus including, e.g., a host state’s tort law? And furthermore: Does any violation of the covered obligations entail the host state’s responsibility or need the breach be of a certain degree, intensity or quality?

As briefly noted in the introduction, when the umbrella clause was first introduced into treaties the intention clearly was to internationalize state contracts. At the time probably nobody had in mind that such a provision could some day apply to obligations under a host state’s law. This indicates that the interpretations by the above tribunals (namely that only specific commitments are covered) go into the right direction (excluding the decision in *LG&E v. Argentina*, of course, according to which a commitment under municipal law could be considered a “specific one”). However, this historical fact does clearly not prevent tribunals from interpreting umbrella clauses in a very broad way (including, e.g., any “obligation” under the host state’s law) in the future.

Since the first appearance of the umbrella clause in ICSID arbitration, the number of cases dealing with this provision has rapidly increased. Due to the far-reaching effects an effective interpretation of the so-called umbrella clause has for investors it can be expected that they will even more frequently base their claims on this provision. It will be interesting to follow the future developments in its interpretation.

⁹⁹ This was asserted, e.g., by the claimant in *Azurix v. Argentina*, par. 382.

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