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# The high-water mark of an umbrella clause: SGS v Paraguay

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In a recent award that arguably represents a high-water mark for the operation of an umbrella clause in ICSID jurisprudence thus far, a tribunal comprising Stanimir A. Alexandrov (as President), Donald Francis Donovan and Pablo Garcia Mexia held Paraguay liable to SGS Société Générale de Surveillance S.A. ("SGS") for failing to pay for services rendered. This case is noteworthy for practitioners because it demonstrates how an investor can, in effect, have its claims arising out of an investment contract readily resolved before a treaty forum through the use of an umbrella clause in a bilateral investment treaty ("BIT").

## I. Background

The facts of the case are similar to previous cases involving SGS. SGS is a Swiss company providing certification services based on pre-shipment inspection of goods. Under a contract entered into between SGS and the Ministry of Finance of Paraguay in 1996 ("the Contract"), SGS was to perform such services for cargoes destined for Paraguay. Sustained attempts by SGS to collect on its invoices failed. There were also alleged oral and written promises by Paraguayian officials to make good on the claimed debt, which were not honoured. SGS commenced ICSID arbitration under the bilateral investment treaty ("BIT") between Switzerland and Paraguay. The BIT contains an umbrella clause under Article 11.

Paraguay resisted jurisdiction on, *inter alia*, the basis that Article 9 of the Contract vests exclusive jurisdiction in the domestic courts of Paraguay. In response, SGS argued that it was not advancing any claims under the Contract and was only asserting claims for breach of the BIT (including breach of the umbrella clause). Paraguay further argued that it was improper to defer to SGS's "labeling" of its claims as being based on treaty rather than contract. In Paraguay's view, a State's non-performance of a contract can only give rise to a BIT violation if sovereign interference can be shown.

## II. Holding

In passages worthy of note by practitioners, the Tribunal first endorsed the oft-cited distinction between treaty claims and contractual claims, *viz*, the fact that an act or

omission may give rise to a contractual claim does not mean that it cannot also separately give rise to treaty claims. It is for SGS to characterize its claims, and the Tribunal will address each claim to see if they are legally and factually adequate for jurisdictional purposes. The threshold at the jurisdictional stage is whether the facts alleged by a claimant could, if proven, make out a claim under the relevant treaty.

The Tribunal did not accept Paraguay's argument that "sovereign interference" was necessary to transform a contractual breach into a treaty violation. It opined that, one could logically characterize every act by a sovereign State as a sovereign act, including contractual breaches to which the State is a party. There was no basis why a State's actions, solely because they occur in the context of a contract or a commercial transaction, are somehow no longer acts of the State.

The Tribunal noted in *dicta* that, even if SGS had brought contractual claims, the wording of the dispute resolution provision in the relevant Treaty was arguably wide enough to encompass those claims, but difficult issues relating to the forum selection clause in the Contract would have been raised. However, since SGS only brought treaty claims before the Tribunal, the forum selection clause in the Contract would not divest the Tribunal of jurisdiction to hear treaty claims.

The Tribunal next addressed each of the treaty claims to see if they were legally and factually adequate for jurisdictional purposes. On the umbrella clause, Paraguay argued that an umbrella clause is implicated only if the host state abuses its power or exerts undue governmental influence in breaching a contract or any other type of undertaking. Paraguay's alternative submission was that the claim for breach of the umbrella clause was inadmissible in light of the forum selection clause in the Contract providing for exclusive jurisdiction of the Paraguayan courts.

The Tribunal rejected Paraguay's arguments in its entirety. The Tribunal first cited the plain and ordinary meaning of the language of the umbrella clause, with Article 31(1) of the Vienna Convention requiring respect for the ordinary meaning of the clause. The Tribunal took the view that the umbrella clause before it "establishes an international obligation for the parties to the BIT to observe contractual obligations with respect to investors." The Tribunal next cited a whole series of reasons to dismiss Paraguay's alternative submission that the claims under the umbrella clause were inadmissible. The reasons are:

(a) SGS's claims under the umbrella clause are not co-extensive with claims under the Contract. SGS advanced claims under the umbrella clause not only for breach of the Contract's payment obligation but also for breach of alleged subsequent commitments by Paraguay's representatives.

(b) Even to the extent that certain claims under the umbrella clause may be co-extensive with claims under the Contract, any argument that the breach of an umbrella clause will not be assessed under an independent, international law standard under the treaty, but under the Contract, is an argument that goes towards jurisdiction at best. Having rejected that jurisdictional argument, the Tribunal would have to have very strong cause to decline the exercise of its jurisdiction.

(c) It would be incongruous to find jurisdiction on the basis of the umbrella clause but then dismiss the claims based on admissibility grounds, because the effect would be to divest the umbrella clause of its core purpose and effect.

(d) The dismissal of claims under the umbrella clause as inadmissible on the ground that a forum selection clause in the Contract is applicable may, in effect, read an implied waiver of treaty rights into every investment agreement that specifies a dispute resolution mechanism other than ICSID.

(e) Given the significance of investors' rights under a BIT, and of the international law "safety net" of protections that they are meant to provide separate from and supplementary to domestic law regimes, they should not lightly be assumed to have been waived. If parties to a later-in-time contract could have expressly excluded the right to resort to arbitration under the extant BIT but do not do so, that silence would not be taken as effecting a waiver of treaty rights.

(f) Other provisions of the BIT between Switzerland and Paraguay, such as the dispute resolution provision itself, contemplate that tribunals constituted under it would be deciding contractual matters and therefore should not be rendered *inutile*.

## III. Comment

This is undoubtedly a decision that investors would welcome. The Tribunal's decision is in marked contrast to two other cases involving SGS over similar facts at hand, namely, *SGS v Pakistan* decided in 2003 and *SGS v Philippines* decided in 2004, which need no introduction to many readers. The tribunal in another parallel case involving Paraguay over the same facts, *BIVAC v Paraguay*, adopted the same approach as the tribunal in *SGS v Philippines*, reasoning that because the investor's contract post-dated the relevant BIT, the contract's forum selection clause should take precedence.

The argument that the claims under the umbrella clause are restricted to breaches based on *sovereign* conduct was rejected by the Tribunal even though tribunals in *El Paso v Argentina* and *CMS v Argentina* have held otherwise. Leaving aside practical difficulties of distinction, the language of the umbrella clauses seen thus far do not justify any distinction between acts that are of a sovereign and acts that are of a non-sovereign character. Moreover, this is consistent with other substantive treaty standards which do not hinge on such a distinction. Both commercial and sovereign conduct are attributable to the State under the international law on state responsibility. Once one accepts that an umbrella clause is a substantive treaty standard as it is meant to be, there is no principled reason why one should enquire about the *nature* of a State's conduct for claims under the umbrella clause, when the same is not done for other treaty standards.

It would appear that the current tide of jurisprudence concerning umbrella clauses is in favour of such clauses encompassing host State commitments of all kinds, including contractual commitments as the Tribunal had unequivocally found in the present case. The significance of *SGS v Paraguay*, however, lies in its holding that, even in the presence of a forum selection clause that the investor had specifically and freely entered into, the tribunal can exercise jurisdiction over claims under the umbrella

clause. This holding is premised on the view that treaty rights provide an alternative choice for the investor and should not be easily whittled away. In an important footnote in its jurisdictional award, the Tribunal further observed that:

> "There is a serious question whether individuals are capable of waiving rights conferred upon them by a treaty between two States…. Because we would not give effect to an alleged waiver that is merely implied, we need not address the question whether we would have given effect to an express waiver."

Leaving aside the question of whether any *express* waiver can be given effect, that a tribunal should not easily give effect to implied waivers must be right. Going back to first principles, once it is accepted that the umbrella clause is an independent treaty standard, it should follow that claims under the umbrella clause, as with any other treaty claims, should be resolved by the treaty forum. The fact that claims under the umbrella clause may be, in effect, identical to contractual claims misses the fundamental point that the umbrella clause itself is an independent treaty standard. A breach of an umbrella clause is a breach of treaty, giving rise to international responsibility. It has been observed that between contractual liability under a national law and international responsibility for breach of treaty, various legal and practical differences exist, spanning interpretation, breach, defences and remedies. This is why it has been said that an approach other the one taken by the Tribunal would effectively render the umbrella clause otiose.

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