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The Umbrella That Won't Open

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Foreword

> "The whole exercise was great fun and for me, I was then 26 years old, a great eye-opener – I learned a lot."

– Sir Elihu Lauterpacht on his advice given to the *Anglo-Iranian Oil Co.* in 1954, on which occasion it emerged the idea that

> "any contract made between, on the one hand, the Company and such other oil companies … and NIOC and/or the Iranian Government on the other, shall be incorporated or referred to in a treaty between Iran and the United Kingdom in such a way that a breach of the contract or settlement shall be *ipso facto* deemed to be a breach of the treaty." (*Conversations with Professor Sir Elihu Lauterpacht*, Second Interview, 2008, Squire Law Library – University of Cambridge, p. 8; and Sinclair, A. C., *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 Arb. Int'l 412 (2004)).

Fifty-eight years later the situation with the *umbrella clause*, given the divergence of views on it, is not that funny. Currently – to the knowledge of the authors – there are forty-four awards and decisions dealing with the question of the umbrella clause; some are representing different stages of the same case, while others are referring to the issue only *obiter dictum*. The recent award rendered in *Bosh v. Ukraine* (ICSID Case no. ARB/08/11, Award of October 25, 2012) is the last one in this long line of cases. We took this case as an occasion to revisit the matter.

Who is left under the rain? Contracts concluded between an investor and a State entity

Of the above mentioned forty-four awards, twenty-two have dealt with the so-called **it** question or, in other words, whether contracts concluded between an investor and a State entity may be assimilated, for jurisdictional purposes, to investor-host State commitments. This is with a view to the language used in most of the umbrella clauses: "Each Contracting Party shall observe any obligation **it** has assumed …"

Sixteen of these twenty-two awards stand of the opinion that it is a precondition for the operation of the umbrella clause that the contract be concluded between the investor and the host State. See for e.g. *Impregilo v. Pakistan*, ICSID Case no. ARB/03/3, Decision on Jurisdiction of April 22, 2005, para. 223; *Azurix v. Argentina*, ICSID Case no. ARB/01/12, Award of July 14, 2006, para. 52; *CMS v. Argentina*, ICSID Case no. ARB/01/8, Decision on the Application for Annulment of September 25, 2007, para. 95(b); *Amto v. Ukraine*, Arbitration no. 080/2005 SCC Rules, Final Award of March 26, 2008, para. 110; *EDF (Services) Limited v. Romania*, ICSID Case no. ARB/05/13, Award of October 8, 2009, para. 318.

As the tribunal in *Gustav F W Hamester GmbH v. Ghana* concluded,

> "a contractual obligation between a public entity distinct from the State and a foreign investor *cannot be transformed by the magic of the so-called 'umbrella clause'* into a treaty obligation of the State towards a protected investor". (*Gustav F W Hamester GmbH v. Ghana*, ICSID Case no. ARB/07/24, Award of June 18, 2010, para. 346, emphasis added, referring to the *CMS Annulment*, para. 95(c); see also *Vivendi v. Argentina*, ICSID Case no. ARB/97/3, Decision on the Application for Annulment of July 3, 2002, para. 96)

The *EDF v. Romania* tribunal added that:

> "[T]he attribution to Respondent of AIBO's and TAROM's acts and conduct *does not render the State directly bound* by the ASRO Contract or the SKY Contract for purposes of the umbrella clause". (para. 318, emphasis added)

The question of attribution under international law simply does not arise. (See *Vivendi First Annulment*, para. 96)

It may be added that the same reasoning applies vis-à-vis contracts concluded between the host State and an investment, i.e. the subsidiary of a protected shareholder. The latter cannot claim – absent specific language in the umbrella clause – rights under a contract to which it is a third party based on the principle *res inter alios acta*. (See Gallus. N., *An Umbrella Just For Two? BIT Obligations Observance Clauses and the Parties to a Contract*, 24 Arb. Int'l 157 (2008))

The inadmissible umbrella

Another interesting question which has been considered by ICSID tribunals is that of the exclusive forum selection clause ("FSC") which gives jurisdiction over all contractual matters to the host State's courts, to the exclusion of any other forum.

The tribunals in the cases of *SGS Société Générale de Surveillance S.A. v. Philippines*, (ICSID Case no. ARB/02/6), *Toto Costruzioni Generali S.p.A. v. Lebanon*, (ICSID Case no. ARB/07/12) and *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. (BIVAC) v. Paraguay* (ICSID Case no. ARB/07/9) have found the umbrella clause claims inadmissible due to such an exclusive FSC contained in the underlying contract. As the tribunal in *Malicorp v. Egypt* usefully explained:

> "In principle, it is up to the party claiming to have been injured by the breach of a contract to pursue its contracting partner using the avenues laid down for this purpose. So long as a procedure of this type exists for protecting investment, it is not possible to resort to the special methods provided for by treaty…" (*Malicorp Limited v. Egypt*, ICSID Case no. ARB/08/18, Award of February 7, 2011, para. 103(c))

Only the decision in *SGS v. Paraguay* stands as an exception in this regard. There the tribunal held that to dismiss the umbrella clause claims on such grounds would be tantamount to "having jurisdiction over an empty shell." (*SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case no. ARB/07/29, Decision on Jurisdiction of February 12, 2010, paras 176-177) This case may be distinguished from *SGS v. Philippine*s, *SGS v. Pakistan* and *BIVAC v. Paraguay* were proceedings have been stayed and dismissed, based on the fact that the decision of the municipal court concerned was a "a factual or legal predicate". (*SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case no. ARB/01/13, Decision on Jurisdiction of August 6, 2003, para. 186; see also *SGS v. Philippines*, Decision on Jurisdiction of January 29, 2004, para. 175; *BIVAC v. Paraguay*, Decision on Jurisdiction of May 29, 2009, para. 161) The *SGS v. Paraguay* approach and overall analysis of the umbrella clause is very interesting and may be commended for saving time and resources in the consolidation of all claims before one body.

On one hand, the reciprocal nature of the obligations owed under a contract must not be disregarded, i.e. the investor cannot be left to absolve himself from the obligation to observe the exclusive FSC as long as it has been freely agreed to. On the other hand, it is the respondent State itself which has refused to pay under the contract. Commenting on the "cherry-picking" argument, the *BIVAC v. Paraguay* tribunal opined that:

> "The broader point, however, having regard to the fundamental principle that the autonomy and will of the parties is to be respected, is that the parties to a contract are not free to pick and choose those parts of the Contract that they may wish to incorporate into an "umbrella clause" provision such as Article 3(4) and to ignore others." (para. 148)

Can the investor rely then on a kind of *exceptio non adimpleti contractus* in order to release himself from the obligation to have recourse to domestic courts? Interestingly, the *SGS v. Philippines* tribunal, which initially stayed the proceedings pending resolution of the contractual dispute, admitted that it was not its intention to order a stay *sine die* and lifted the stay. (See *SGS v. Philippines*, Order on Further Proceedings of December 17, 2007, para. 5) It may thus be read between the lines of the order in *SGS v. Philippines* that if the parties continue to disagree on the contractual dispute, the stay will be eventually lifted but at additional cost of time and resources.

Can an umbrella clause be imported by the operation of an MFN clause?

As recently as 2006, Yannaca-Small has estimated that about 40% of the then existing BITs contained umbrella clauses. (See Yannaca-Small, K., *Interpretation of the Umbrella Clause in Investment Agreements*, OECD Working paper Number 2006/3, p. 5) This leads to the question whether this percentage can be increased by importing umbrella clauses through the operation of an MFN clause, where applicable.

At the time of writing, only three tribunals have been seized with such claims but found it unnecessary under the circumstances to rule definitely on the question. See *Impregilo v. Argentina* (ICSID Case no. ARB/07/17, Award of June 21, 2011), *Abaclat v. Argentina* (ICSID Case no. ARB//07/5, Decision on Jurisdiction of August 4, 2011, para. 322) and *Siag v. Egypt* (ICSID Case no. ARB/05/15, Award of June 1, 2009, para. 464). Still, the *Impregilo v. Argentina* case suggests that this question should be answered in the negative:

> ”The substantive protection of the MFN clause is very wide in so far as it relates to all matters regulated by the BIT. Nevertheless, the reference to matters regulated by the BIT sets an outer limit, and it is debatable whether contractual breaches are matters regulated by the BIT.” (para. 184)

What is under the umbrella?

The question regarding the scope and effect of the umbrella clause has divided tribunals and scholars alike. Despite fears of “opening the floodgates”, only in eight cases have the tribunals read into the text of the applicable umbrella clause non-textual limitations such as a requirement of the host State’s exercise of “*puissance publique*” (See *Impregilo v. Pakistan*, para. 260; *El Paso v. Argentina*, ICSID Case no. ARB/03/15, Decision on Jurisdiction of April 27, 2006, para. 79; *Sempra v. Argentina*, ICSID Case no. ARB/02/16, Award of September 28, 2007, para. 310), or a special link between the contract and the investment (*Duke Energy v. Ecuador*, ICSID Case no. ARB/04/19, Award of August 18, 2008, para. 324) or that the contract be an investment contract (see for e.g. *El Paso v. Argentina*, para. 77; *Pan American & BP America v. Argentina*, ICSID Case nos. ARB/03/13 and ARB/04/8, Preliminary Objections of July 27, 2006, para. 106, which distinguish between “ordinary commercial contract” and an “investment agreement”)

To give an example, consider the reasoning of the *SGS v. Philippines* tribunal which found that non-payment under the contract does not amount to expropriation:

> "…no case of expropriation has been raised. Whatever debt the Philippines may owe to SGS still exists; whatever right to interest for late payment SGS had it still has. There has been no law or decree enacted by the Philippines attempting to expropriate or annul the debt, nor any action tantamount to an expropriation…" (Decision on Jurisdiction, para. 161)

It becomes obvious that if the umbrella clause (in order to have effect) was intended to give extra protection, as was stated in *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentina*, ICSID Case no. ARB/02/1, Decision on Liability of October 3, 2006, para. 170, – i.e. to provide for cases other than expropriation, breach of the FET standard, etc. which already presuppose governmental authority – the exercise of *puissance publique* is not a condition for the operation of the clause.

It may thus be concluded that it is now settled that the umbrella clause means what is says and will cover "any commitments", as the language of most of such clauses provides. (This is, of course, subject to the caveat that umbrella clauses are not uniform and due regard must be paid to their exact wording.) Such "commitments" include, but are not limited to, contractual obligations and must be specific, that is, they cannot be contained in acts of general application such as national legislation. (See *LG&E v. Argentina*, para. 174; *GEA Group v. Ukraine*, ICSID Case no. ARB/08/16, Award of March 31, 2011, para. 354 applying the test of "clear and unambiguous promise".)

In conclusion on the issue of the effect of the umbrella clause, it emerges from the arbitral practice that these clauses represent a mechanism to grant tribunals jurisdiction over contractual claims. The proper law of the contract (*lex contractus*) does not change, i.e. it is not substituted for international law. A breach of the contract will, however, entail the host State's responsibility under international law. (See for e.g. *SGS v. Philippines*, Decision on Jurisdiction, para. 128; *CMS Annulment*, para. 95(c); *BIVAC v. Paraguay*, para. 142; *Toto v. Lebanon*, Decision on Jurisdiction of September 11, 2009, para. 202. See also Newcombe & Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, Kluwer L. Int'l: 2009, p. 450)

Notably, the question whether an umbrella clause claim qualifies as a treaty claim proper remains somewhat ambiguous. To give an example, under the *Vivendi* "fundamental basis of the claim" test (See *Vivendi First Annulment*, para. 101), it would qualify as a contract claim and thus a FSC would operate as a bar to admissibility. Similarly, the *BIVAC v. Paraguay* tribunal held that:

> "In the present case, in relation to Article 3(4) we do not see how it could be concluded that 'the fundamental basis of the claim' was the BIT rather

> than the Contract. Any other approach strikes us as being so artificial as to be unreasonable.” (para. 149)

On the other hand, the tribunals in *Burlington Resources v. Ecuador* (ICSID Case no. ARB/08/5, Decision on Jurisdiction of 2 June 2010, para. 189) and *SGS v. Paraguay* (Decision on Jurisdiction, para. 166) held that umbrella claims are treaty claims. This question would also affect that of circumstances precluding wrongfulness. Thus in *Continental Casualty v. Argentina* the tribunal accepted the plea of necessity for the breach of the umbrella clause (*Continental Casualty v. Argentina*, ICSID Case no. ARB/03/9, Award of September 5, 2008, para. 303), while in *SGS v. Paraguay* the tribunal dealt with excuses under the applicable *municipal law* (*SGS v. Paraguay*, Award of 10 February 2012, paras. 112-156).

What is the scope *ratione temporis* of the umbrella clause?

The *SGS v. Philippines* case suggests that “a host State assumes obligations with regard to specific investments *at the time of entry*”. (*SGS v. Philippines*, Decision on Jurisdiction, para. 117, emphasis added) On the other hand, in *SGS v. Paraguay* the respondent State was held to account for failing “to abide by *subsequent* alleged promises to honour the Contract and to pay such debts”. (*SGS v. Paraguay*, Decision on Jurisdiction, para. 163, emphasis added) In view of the text of Article 25 of the ICSID Convention requiring an existing “investment” as a condition for jurisdiction *ratione materiae* it may not be argued that undertakings preceding the establishment of the investment (pre-investment activities) fall within the purview of the umbrella clause.

Does the umbrella clause protect contractual obligations which may have already been time-barred under the applicable municipal law?

This question may be answered in the affirmative. The *SGS v. Paraguay* tribunal reasoned that “the BIT at issue in this dispute does not contain a limitation period that would prevent Claimant from bringing a claim several years after the events in question took place”. (*SGS v. Paraguay*, Award, para. 166; see also *Bayindir v. Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction of November 14, 2005, para. 165)

How does the operation of the umbrella clause affect the question of remedies?

This question is important specifically for the avoidance of double-counting. The *CMS v. Argentina* ad-hoc committee, in annulling only paragraph 1 of the operative part of the award, recalled that “the umbrella clauses invoked by the Claimant do not add anything different to the overall Treaty obligations”. This partial annulment did not, as a consequence, affect the amount of compensation. (*CMS Annulment*, para. 100) The *SGS v. Paraguay* tribunal, on the other hand, accepted that:

> “In light of the Tribunal’s conclusion that Respondent breached Article 11 of the BIT by failing to meet its payment obligations under the Contract,

> the Tribunal need not address Claimant's remaining claims. Each of those claims arises from the same facts, and reduces to a claim that Respondent failed to pay the invoices. Even if the Tribunal were to find in favor of Claimant with respect to these claims, Claimant's damages would be unchanged." (*SGS v. Paraguay*, Award, para. 161)

Introducing contract claims through the back door

Before concluding, it deserves mentioning the problem of broad dispute resolution clauses contained in some BITs, using language which has sometimes been viewed as permitting the tribunal to deal with contract-based claims, for e.g. dispute resolution clauses defining an investment dispute under the BIT as "*any* dispute between a Party and a national or company of the other Party arising out of or relating to an investment".

The better view is that such clauses are not an independent treaty standard and cannot (especially in the absence of an umbrella clause) serve to introduce contract claims through the back door. The contrary would render the substantive standards of protection superfluous; in order to establish the tribunal's jurisdiction it would suffice to have a broad dispute resolution clause only. See *Vivendi First Annulment*, para. 55; SGS v. Pakistan, para. 161.

Postscript. What is the forecast for tomorrow?

The umbrella clause has turned into a tug-of-war between investors and host States. A review of the arbitral practice already suggests that we are now close to achieving uniformity on most of the thorny issues involved in the umbrella clause debate – bit by bit and BIT by BIT. The clear victors would be both the investor and the respondent State since predictability is important not only in arbitration but it is fundamental to the legal order.

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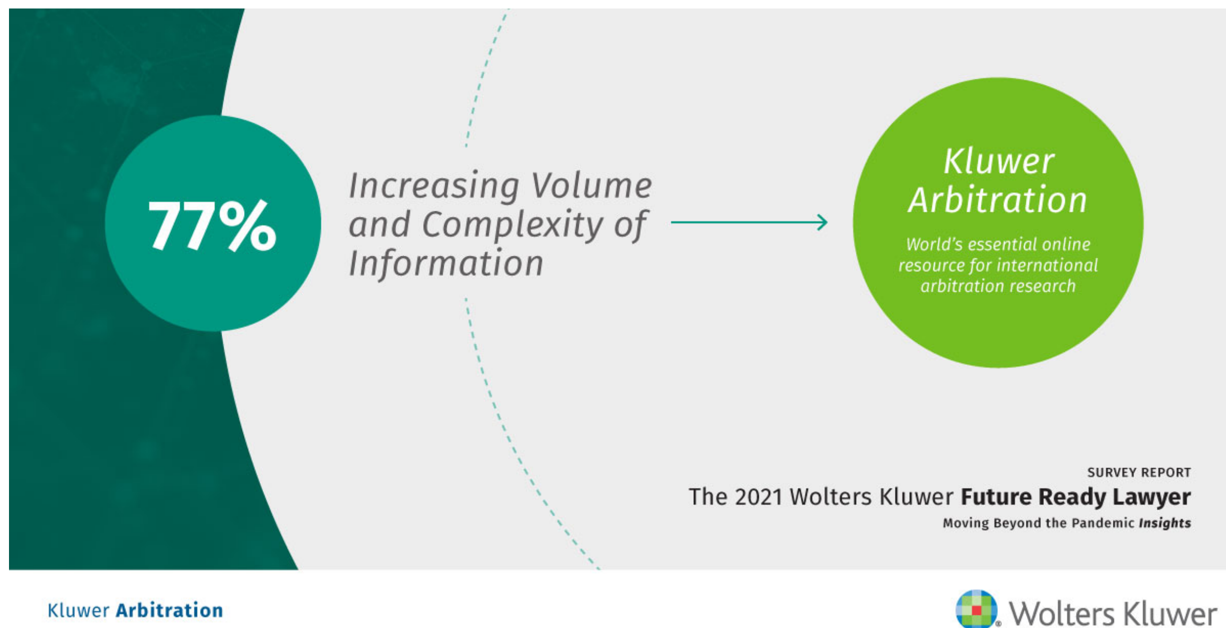

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