Kluwer Arbitration Blog

Umbrella Clause Decisions: The Class of 2012 and a Remapping of the Jurisprudence

Patricio Grané (Arnold & Porter LLP) · Thursday, January 17th, 2013

by Patricio Grané and Brian Bombassaro

The year 2012 brought eight new investor-state arbitration decisions on umbrella clauses.[1)] Although tribunals in three of the disputes resolved claims without confronting controversial aspects of umbrella clauses,[2)] the other five tribunals issued yet another vintage of divergent decisions. Placing the decisions of 2012 within the framework of prior umbrella clause decisions also presents an opportunity to examine how that framework has been evolving.

Early Development of the Umbrella Clause Jurisprudence

Umbrella clauses, known also as "observance of undertakings" clauses, are common to investment treaties and exist in myriad formulations. Under a more expansive version, each state commits to "observe any obligation it may have entered into with regard to investments."[3)] Controversy over these provisions erupted in August 2003 with the decision in *SGS v. Pakistan*. Concerned that, "[a]s a matter of textuality," the umbrella clause "appears susceptible of almost indefinite expansion," the tribunal in that case held that the claimant needed to adduce "clear and convincing evidence" that the parties to the investment treaty intended that the umbrella clause elevate a contract breach to the level of a treaty breach.[4)] Finding that the claimant failed to provide sufficient evidence, the tribunal rejected its proposed interpretation and denied the claim.[5)]

Only five months later, in January 2004, the tribunal in *SGS v. Philippines* interpreted another umbrella clause, worded slightly differently,[6)] to "say, and to say clearly, that each Contracting Party shall observe any legal obligation it has assumed, or will in the future assume, with regard to specific investments covered by the BIT."[7)] But despite firmly concluding that the provision "means what it says,"[8)] the tribunal then decided that an exclusive forum selection clause in the contract precluded it from adjudicating the alleged breach of contract, a necessary antecedent to deciding the treaty claim. As a result, the tribunal stayed arbitration proceedings pending resolution of the contract claim in the forum contemplated in the contract.

Since then, discussion about umbrella clauses has tended to begin with a framework in which *SGS v. Pakistan* and *SGS v. Philippines* rest at the two poles: *SGS v. Pakistan* as the "narrow" or restrictive interpretation, and *SGS v. Philippines* as the "broad" interpretation. Meanwhile, an

intermediate set of decisions exists in which a pivotal element is the nature of the state's conduct — whether the state formed or breached the contract acting in its capacity as a sovereign (*ius imperii*), or acting solely in a commercial capacity (*ius gestionis*).[9)]

Evolution from the Early Umbrella Clause Jurisprudence

Not all umbrella clause decisions, including those rendered in 2012, however, fit neatly in one of these three categories. For instance, there have been decisions that focus on the issue of contract privity; that is, whether claimants may base an umbrella clause claim on contractual obligations that are not due directly from the state to the investor (for example, when either a state agency or an investor subsidiary, rather than the state itself or the investor itself, is party to the contract). On this issue of contract privity, the jurisprudence is not unified. Other decisions have focused on whether an umbrella clause covers any legislative and regulatory obligations or only such obligations that specifically address investors.

Another development that justifies rethinking the traditional mapping of the umbrella clause jurisprudence is the emergence of a decision that appears to be more favorable to claimants than *SGS v. Philippines*, therefore expanding the range of umbrella clause decisions and succeeding *SGS v. Philippines* as the representative of the "broad" pole. In February 2010, the *SGS v. Paraguay* tribunal found the umbrella clause to mean that a contract breach leads to a treaty breach, while also finding — unlike *SGS v. Philippines*[10)] — that a forum selection clause in the contract was no obstacle to reaching this legal conclusion. The *SGS v. Paraguay* tribunal explicitly rejected "non-textual limitations" to the umbrella clause that the respondent had proposed.[11)]

In light of these developments since the initial two SGS disputes, a remapping of the landscape of umbrella clause decisions is warranted. A more accurate categorization of the decisions could still encompass three categories, but defined in a slightly different manner. *First*, there is the narrow or restrictive pole, of which *SGS v. Pakistan*, with its avowed "prudential" interpretation,[12)] remains the hallmark. *Second*, there is the broad "plain meaning" pole, but instead of *SGS v. Philippines*, its standard-bearer would be *SGS v. Paraguay*. In a *third* and more nuanced category, between the two poles, are a cluster of decisions that reflect a "conditional plain meaning" application of umbrella clauses.

The "conditional plain meaning" group would include, among others, *SGS v. Philippines*. The *SGS v. Philippines* tribunal reached a plain meaning interpretation, but before the investor could vindicate its rights, it first needed to abide by the contract's forum selection clause — essentially an implied condition that the claimant reciprocate observation of contractual obligations,[13)] with the submission of disputes to the selected forum being an obligation that the investor owes to the state. Later decisions, such as *Toto Costruzioni v. Lebanon* and *BIVAC v. Paraguay*, have followed *SGS v. Philippines* when examining similar scenarios. Together, these decisions constitute one line of holdings within the "conditional plain meaning" category.

Other tribunals have likewise been willing to grant claimants access to a plain meaning interpretation while subjecting that access, for practical purposes, to conditions. At least five such conditions are identifiable: for claims founded on a contract breach, (1) that the investor comply with its own contract obligations, viz., that it honor a forum selection clause in the contract, (2) that the state *entered* the contract as an act of *ius imperii*, (3) that the state *breached* the contract as an act of *ius imperii*, and (4) that the state and claimant each be parties to the contract (i.e., privity of

contract). The fifth condition is unique to the context of legislative or regulatory obligations: (5) that the legislative or regulatory obligations target investors specifically. Some of these conditions could prove to be quite restrictive in effect and, collectively, could even be insurmountable.

2012 Count: Narrow: 0; Broad: 2; Conditional: 3; Abstaining: 3

Using the new framework identified above, an attempt may be made to classify the eight umbrella clause decisions that tribunals issued in 2012:

Narrow, Restrictive, or Prudential

• No decisions of 2012 seem to fit in this category.

Broad, Unconditional Plain Meaning

• *SGS v. Paraguay* (Feb. 2012) (rejecting conditions #1 and #3): Contract obligations regarding forum selection had no bearing on whether the state breached other, independent obligations in the contract, and the state failed to establish that if the investor had breached other aspects of the contract, which was not proven, then such breach would have relieved the state of its contractual obligations; breach of the umbrella clause did not require an abuse of sovereign power.

• *EDF v. Argentina* (June 2012) (rejecting condition #4): Breach of a contract between an Argentine province and a company in which the claimant was a majority shareholder constituted a breach of the umbrella clause (although also suggestive that a breach of the umbrella clause may require that the contract breach be due to an act of *ius imperii*, condition #3)

Conditional Plain Meaning

• *BIVAC v. Paraguay* (Oct. 2012) (endorsing condition #1): Following its decision of 2009, the tribunal issued a continued stay pending a disposition of the alleged contract breach in Paraguayan courts. In the prior award, the tribunal determined that an exclusive forum selection clause in the contract rendered the umbrella clause claim inadmissible. In the 2012 decision, the tribunal remarked that if the state does not comply with any eventual decision by Paraguayan courts, the umbrella clause claim "might then become admissible."[14)]

• *Bosh v. Ukraine* (Oct. 2012) (endorsing condition #1): The alleged contract breach was not attributable to the state, but even if the alleged breach had been attributable to the state, the tribunal would have deferred to a forum selection clause in the contract and denied the umbrella clause claim.

• *Burlington Resources v. Ecuador* (majority) (Dec. 2012) (endorsing condition #4): Because only a subsidiary of the claimant was privy to the contract, not the claimant itself, the tribunal rejected the umbrella clause claim. (The dissenting opinion, by Francisco Orrego Vicuña, would fall in the category of broad or unconditional plain meaning; Orrego Vicuña opined that the BIT's umbrella clause covered contractual obligations related to direct or indirect investments regardless of whether the obligation was due directly to the claimant, rejecting condition #4.)

The three remaining decisions from 2012 did not discuss in detail the umbrella clauses at issue in those cases. In *Swisslion v. FYROM* (July 2012), the tribunal found that the claimant was unable to establish any contract breach, thus obviating any need to interpret the provision in depth. In *Daimler Financial Services v. Argentina* (Aug. 2012) and *Occidental v. Ecuador* (Oct. 2012), the tribunals likewise reached a disposition without entangling themselves in the more controversial elements of an umbrella clause interpretation. In *Daimler Financial Services*, the tribunal found the

argument against its jurisdiction over umbrella clause claims to be "patently groundless."[15] In *Occidental*, the tribunal found that the state was in breach even under its own proposed interpretation of the umbrella clause.

While classifying the range of umbrella clause decisions is useful for understanding how tribunals have applied such clauses, caution is due in attempting to generalize. Each decision typically examines only a particular umbrella clause (which, as noted, can take any of myriad textual formulations) in a specific fact scenario. Also, decisions that rejected possible implied conditions did not evaluate *every* recognized or potential implied condition, so they should be viewed as suggesting an unconditional plain meaning *only* with regard to the proposed conditions that the tribunals considered and rejected.

Conclusion: More Evolution To Come

The decisions of 2012 did not bridge the chasm that separates divergent conclusions on umbrella clauses. But those decisions nevertheless contribute to the jurisprudence by helping to more clearly identify and delineate patterns that have developed over nearly a decade of searching inquiries. Perhaps 2013 will bring more clarity on this issue, but it is reasonable to expect that umbrella clauses will remain among the most controversial and uncertain areas of international investment law, at least for the near future.

**Patricio Grané is Counsel of Arnold & Porter LLP and Adjunct Professor of Law at Georgetown University Law School; Brian Bombassaro[16] is an associate at Arnold & Porter LLP. The opinions expressed by the authors are their own and should not be attributed or used against any past, existing, or future client of Arnold & Porter LLP.*

References

(1) Société Générale de Surveillance S.A. v. Republic of Paraguay, ICSID Case No. ARB/07/29, Award (Feb. 10, 2012), (2) EDF International S.A., SAUR International S.A. and Leon Participaciones Argentinas S.A. v. Argentine Republic, ICSID Case No. ARB/03/23, Award (June 11, 2012) (3) Swisslion DOO Skopje v. The former Yugoslav Republic of Macedonia, ICSID Case No. ARB/09/16, Award (July 6, 2012), (4) Daimler Financial Services AG v. Argentine Republic, ICSID Case No. ARB/05/1, Award (Aug. 22, 2012), (5) Occidental Petroleum
?1 Corporation and Occidental Exploration and Production Company v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award (Oct. 5, 2012), (6) Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay, ICSID Case No. ARB/07/9, Further Decision on Objections to Jurisdiction (Oct. 9, 2012), (7) Bosh International, Inc. and B & P Ltd. Foreign Investments Enterprise v. Ukraine, ICSID Case No. ARB/08/11, Award (Oct. 25, 2012), and (8) Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012).

?2 *Swisslion v. The former Yugoslav Republic of Macedonia* (2012), *Daimler Financial Services v. Argentine Republic* (2012), and *Occidental v. Ecuador* (2012).

?3 *E.g.*, Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, art. II(2)(c) (Oct. 20, 1994).

?4 Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction, ¶¶ 166-67 (Aug. 6, 2003).

?5 *Id.* ¶¶ 165, 173.

The arguably material distinctions between the two umbrella clauses are in the phrases “shall constantly guarantee the observance of commitments it has entered” in the Swiss-Pakistan BIT and, in the Swiss-Philippines BIT, “shall observe any obligation it has assumed.” Société Générale
?6 de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶¶ 115, 119 (Jan. 29, 2004). The *SGS v. Philippines* tribunal commented that the umbrella clause of the Swiss-Pakistan BIT is “formulated in different and rather vaguer terms” and is “less clear and categorical.” *SGS v. Philippines* (2004) ¶ 119.

Id. ¶ 115. Opinions differ on whether this "broader" interpretation is attributable to the textual distinctions. *Compare, e.g.*, Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, Award, ¶ 56 ("{I}t is the differences in the wording . . . that go far to explain the different positions taken by different ICSID tribunals that have in recent times had to consider {umbrella} clauses."), *with* Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, ¶ 138 (May 29, 2009) ("{T}he two decisions {in *SGS v Pakistan* and *SGS v. Philippines*} cannot be reconciled, reflecting different approaches to this issue.").

?7

?8 *SGS v. Philippines* (2004) ¶ 119.

One such line of decisions looks to the nature of the conduct through which the contract was *formed* (for example, El Paso Energy International Company v. Argentine Republic, ICSID Case No. ARB/03/15, Decision on Jurisdiction, ¶¶ 79-80 (Apr. 27, 2006)), while another looks to the nature of the state conduct that is alleged to have *breached* the contract (for example, Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶ 310 (Sept. 28, 2007)).

?9

Arbitrator Antonio Crivellaro wrote a separate declaration endorsing an approach akin to that of *SGS v. Paraguay*, in which the forum selection clause would not render the umbrella clause claim inadmissible. Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Declaration (Jan.29, 2004).

?10

?11 *SGS v. Paraguay* (2010) ¶ 168.

?12 *SGS v. Pakistan* (2003) ¶ 171.

Among the reasons that the *SGS v. Philippines* tribunal provided for its determination that the exclusive forum selection clause rendered the treaty claim inadmissible was "the principle that a party to a contract cannot claim on that contract without itself complying with it." *SGS v. Philippines* (2004) ¶ 154.

?13

?14 *BIVAC v. Paraguay* (2012) ¶ 290.

?15 *Daimler Financial Services v. Argentina* (2012) ¶ 283.

Not admitted to the practice of law. Practicing law in the District of Columbia pending approval of application for admission to the DC Bar and under the supervision of lawyers of the firm who are members in good standing of the DC Bar.

?16

This entry was posted on Thursday, January 17th, 2013 at 9:31 pm and is filed under Foreign Investment Law, Investment agreements, Investment Arbitration, Umbrella clause
You can follow any responses to this entry through the Comments (RSS) feed. You can skip to the end and leave a response. Pinging is currently not allowed.