

## **LLM DISSERTATION COVER SHEET**

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## INTRODUCTION

Umbrella clauses are standards of protection which are typically included in treaties by states to ensure that the host state observes its obligations towards foreign investors. The use of umbrella clauses in Bilateral Investment Treaties (BITs) is by no means recent. The first investment treaty, concluded in 1959 between Germany and Pakistan, contained an umbrella clause.<sup>1</sup> Since then such clauses have regularly featured in BITs. It was once estimated that approximately 40 per cent of all BITs contain an umbrella clause.<sup>2</sup>

States have recently started to omit the umbrella clause from new-generation investment treaties and model BITs.<sup>3</sup> The United Nations Conference on Trade and Development (UNCTAD) has attributed this to inconsistent interpretation of the clause in recent cases by International Centre for Settlement of Investment Disputes (ICSID) Tribunals and the move of states towards safeguarding their policy space or right to regulate.<sup>4</sup>

This paper focuses on whether and, if so, to what extent inconsistent interpretation of umbrella clauses by investment tribunals and the efforts of states to safeguard their right to regulate can explain the recent trend away from including umbrella clauses. While other motives for the omission of the clause may be ascertained from state practice, these motives will not be explored in this paper.

The first section of this paper highlights the trend to leave umbrella clauses out of recent BITs. It also emphasizes some of the differences between how states have chosen to do this. Having established that a trend away from inclusion is indeed under

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<sup>1</sup> Anthony C Sinclair, 'The Origins of the Umbrella Clause in the International Law of Investment Protection' (2004) 20 *Arbitration International* 411, 433.

<sup>2</sup> Judith Gill, Matthew Gearing and Gemma Birt, 'Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases' (2004) 21:5 *Journal of International Arbitration* 397, at footnote 31.

<sup>3</sup> Raúl Pereira de Souza Fleury, 'Umbrella Clauses: A Trend towards Its Elimination' (2015) 31 *Arbitration International* 679, 680.

<sup>4</sup> UNCTAD, 'World Investment Report 2015: Reforming International Investment Governance' (2015b) New York: United Nations Publication 133.

way, the second and third sections examine the reasons espoused by UNCTAD for this. The issue of inconsistent interpretation of the umbrella clause is the focus of the second section. It will analyze the question of interpretation by focusing on some seminal cases and the possible effects of these cases on states. In the third section, the paper examines the possible consequences of an umbrella clause on a state's right to regulate, and in particular whether the clause could constrain the right to regulate by narrowing a state's policy space.

After examining both of the grounds or motives for not including such a clause, this paper concludes that inconsistent interpretation and the desire to safeguard the right to regulate could explain the trend away from the inclusion of an umbrella clause. It also points out that more options for reform than outright omission are available to states.

## 1 – The TREND AWAY from INCLUSION

In several of its recent reports, UNCTAD has proposed as a reform option that states should not include an umbrella clause in BITs if they wish to evade some of the significant legal consequences that arise from including one.<sup>5</sup> So states may reflect these reforms in their investment obligations, UNCTAD has also emphasized the urgency of modernizing old-generation investment treaties. The old-generation treaties – International Investment Agreements (IIAs) concluded between 1959 and 2011 – still represent 90 per cent of IIAs in operation today. For UNCTAD, these treaties indicate significant policy challenges.<sup>6</sup>

Apart from modernization through amendments reforms are also increasingly initiated through replacing old-generation treaties with newer, modern IIAs. For instance, thirty BITs were concluded in 2018, and four of these treaties replaced old-generation treaties. It can be argued that replacement offers the parties the opportunity to implement some of the reforms suggested by UNCTAD.<sup>7</sup>

UNCTAD has recently observed that the content of recent treaties commonly diverges from the old-generation treaties in numerous areas. One of these areas concerns the use of umbrella clauses in BITs.<sup>8</sup> As mentioned above, UNCTAD has attributed this recent divergence to inconsistent interpretation of the clause, and the trepidation of state's regarding their policy space. Likewise, Fleury points out that this trend might be a response to the inconsistent interpretation of such clauses by investment tribunals.<sup>9</sup>

This trend can be readily observed in reports published by UNCTAD every year. For example, in its 2017 World Investment Report UNCTAD reviewed eighteen IIAs

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<sup>5</sup> UNCTAD, 'UNCTAD's Reform Package for the International Investment Regime' (2018b) New York: United Nations Publication 45; UNCTAD, 'UNCTAD's Investment Policy Framework for Sustainable Development' (2015a) New York: United Nations Publication 102.

<sup>6</sup> UNCTAD, 'Taking Stock of IIA Reform: Recent Developments' (2019a) 3 IIA Issues Notes 4.

<sup>7</sup> UNCTAD, 'World Investment Report 2019: Special Economic Zones' (2019b) New York: United Nations Publication 110.

<sup>8</sup> UNCTAD, 'World Investment Report 2018: Investment and New Industrial Policies' (2018c) New York: United Nations Publication 96.

<sup>9</sup> de Souza Fleury (n 3), 680.

concluded in 2016. The report found that only two of the treaties had contained an umbrella clause.<sup>10</sup> In its 2018 World Investment Report, UNCTAD compared a sample of twenty-six treaties, thirteen of which were concluded in 2017, and the remainder in 2000. The report found that, while in 2000 only five of the treaties had not included an umbrella clause, twelve of the treaties concluded in 2017 did not include one. Likewise, twenty-nine treaties were concluded in 2018, and notably only one of these treaties incorporated an umbrella clause.<sup>11</sup>

Fleury, in an article published on 13 October 2017, analyses fifty-two investment treaties signed since December 2015 and two model BITs prepared by India and Norway, and demonstrates that out of these fifty-four documents only two include an umbrella clause.<sup>12</sup>

The trend can also be seen in multilateral agreements. For example, the ASEAN–Australia–New Zealand Free Trade Area Agreement,<sup>13</sup> the North American Free Trade Agreement,<sup>14</sup> and the EU–Canada Comprehensive Economic and Trade Agreement (CETA)<sup>15</sup> do not incorporate an umbrella clause. Seemingly, Canada did not want such a clause included in CETA: during negotiations, it made no suggestion on the matter, while the EU proposed an umbrella clause with reduced scope, applying only in cases in which the state exercises governmental authority.<sup>16</sup> One exception to this trend is the Energy Charter Treaty, which does include an umbrella clause.<sup>17</sup> However,

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<sup>10</sup> UNCTAD, 'World Investment Report 2017: Investment and the Digital Economy' (2017b) New York: United Nations Publication 120.

<sup>11</sup> UNCTAD (2019a) (n. 6), 2.

<sup>12</sup> Raúl Pereira de Souza Fleury, 'Closing the Umbrella: A Dark Future for Umbrella Clauses? Kluwer Arbitration Blog' (2017) <<http://arbitrationblog.kluwerarbitration.com/2017/10/13/closing-umbrella-dark-future-umbrella-clauses/>> accessed 2 August 2019.

<sup>13</sup> Agreement Establishing the ASEAN–Australia–New Zealand Free Trade Area, Chapter 11 <[https://www.asean.org/uploads/2012/10/Agreement Establishing the AANZFTA.pdf](https://www.asean.org/uploads/2012/10/Agreement%20Establishing%20the%20AANZFTA.pdf)> accessed 2 August 2019.

<sup>14</sup> North American Free Trade Agreement, Chapter 11 <<https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement>> accessed 2 August 2019.

<sup>15</sup> EU–Canada Comprehensive Economic and Trade Agreement, Chapter 8 <[http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf)> accessed 2 August 2019.

<sup>16</sup> PJ Kuijper, 'Investment Protection Agreements as Instruments of International Economic Law', Study for the European Parliament, 18 <<https://doi.org/10.2861/68289>> accessed 2 August 2019.

<sup>17</sup> The Energy Charter Treaty, Art.10(1) <<https://energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf>> accessed 2 August 2019.

it must be mentioned that the treaty does allow countries to opt out of this provision and countries such as Australia, Canada and Norway have chosen to do so.

UNCTAD has also recently initiated an effort to map the content of IIAs. According to this project, 56 per cent of the 1,771 treaties concluded between 1959 and 2000 did not include an umbrella clause. The trend to exclude them can clearly be seen when the treaties concluded between 2011 and 2016 are examined: in those five years, 110 BITs were signed, and 83 (75 per cent) of these treaties did not contain an umbrella clause.<sup>18</sup>

The practice of states regarding the incorporation of the clause, however, is not uniform. While the investment treaties of countries such as the United Kingdom and Germany frequently include an umbrella clause, only a minority of the BITs concluded by France and Japan incorporate such a clause.<sup>19</sup> Before 2009 Canada was the only member of the Organisation for Economic Co-operation and Development (OECD) that had never incorporated an umbrella clause in its BITs; today Canada has two current BITs that do so.<sup>20</sup> It is important to emphasize that countries that have been negatively affected by the application of umbrella clauses have chosen not to include such a clause in their modern BITs.<sup>21</sup> For example, the Philippines and Paraguay, both of which have been adversely affected by the inconsistent interpretation of such clauses by investment tribunals, have not included an umbrella clause in their most recent BITs.<sup>22</sup>

Umbrella clauses are also notably absent from the third-generation BITs concluded by China. Although an umbrella clause was frequently included in second-generation

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<sup>18</sup> UNCTAD Investment Policy Hub IIA Mapping Project  
<<https://investmentpolicy.unctad.org/international-investment-agreements/iaa-mapping>> accessed 2 August 2019.

<sup>19</sup> Katia Yannaca-Small, 'Interpretation of the Umbrella Clause in Investment Agreements' (2006) 2006/3 OECD Working Papers on International Investment 5.

<sup>20</sup> UNCTAD Investment Policy Hub IIA Mapping Project (n. 18).

<sup>21</sup> de Souza Fleury (n. 3) 690.

<sup>22</sup> Paraguay–Italy BIT, signed in 1999, entered into force in 2013, <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3391/download>> accessed 2 August 2019; Philippines–Turkey BIT, signed in 1999, entered into force in 2006 <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2177/download>> accessed 2 August 2019.

BITs by China, new-generation treaties usually do not contain such clauses.<sup>23</sup> Likewise, the US Model BIT does not contain an umbrella clause.<sup>24</sup> Although the US Model BIT does protect contractual claims,<sup>25</sup> it does not consider that breach of contract constitutes breach of treaty, and such claims are protected according to the law stated in the contract.<sup>26</sup>

Overall, it can be concluded that while there may be some inconsistencies in state practice on including umbrella clauses in recently concluded BITs,<sup>27</sup> there is a visible trend not to do so. This is most clearly demonstrated by the data provided by UNCTAD, which shows that 75 per cent of treaties signed between 2011 and 2016 did not contain an umbrella clause.<sup>28</sup>

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<sup>23</sup> Elodie Dulac, 'The Emerging Third Generation of Chinese Investment Treaties' (2010) 7 *Transnational Dispute Management* 1, 17.

<sup>24</sup> 2012 US Model Bilateral Investment Treaty <<https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>> accessed 2 August 2019.

<sup>25</sup> *Ibid.*, Art.24(1)(A)(I)(C).

<sup>26</sup> *Ibid.*, Art.30(2).

<sup>27</sup> The Austria–Kyrgyzstan BIT, which was signed in 2016, contains an umbrella clause <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5500/download>> accessed 2 August 2019.

<sup>28</sup> UNCTAD Investment Policy Hub IIA Mapping Project (n. 18).

## 2 – The UMBRELLA CLAUSE and INCONSISTENT INTERPRETATION

As was pointed out in the introduction to this paper, in several of its reports UNCTAD has ascribed the exclusion of an umbrella clause from new-generation investment treaties to the inconsistent interpretation of the clause by investment tribunals.<sup>29</sup> It has recommended that states reform their old-generation investment treaties and suggested some policy options for adoption, one being the omission of umbrella clauses.<sup>30</sup>

Before 2003, an umbrella clause, although a regular feature of many investment treaties, did not receive much notice in arbitral practice and was not a popular point for academic discussion.<sup>31</sup> Those who did write about the clause seemed to share the view that the purpose of the clause was to transform violations of a contract into breaches of the treaty itself.<sup>32</sup>

Mann states that an umbrella clause “is a provision of particular importance in that it protects the investor against any interference with his contractual rights”.<sup>33</sup> Academic discussions regarding the BIT practice of the United States and Germany also attribute the same influence to the umbrella clause.<sup>34</sup>

The unanimity on the effect of the umbrella clause ended in 2003 with the ICSID arbitral decision in *SGS v Pakistan*.<sup>35</sup> The ICSID Tribunal noted some of the arguments on the effects that an expansive interpretation of the clause would create and refused to accept such an interpretation.<sup>36</sup> Since this case, the scope and purpose of umbrella

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<sup>29</sup> UNCTAD (2015a) (n. 5), 15; UNCTAD (2018b) (n. 5), 75.

<sup>30</sup> UNCTAD (2015b) (n. 4), 144.

<sup>31</sup> Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2012), 168.

<sup>32</sup> Christoph Schreuer, ‘Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road’ (2004) 5 *The Journal of World Investment & Trade* 231, 250.

<sup>33</sup> FA Mann, ‘British Treaties for the Promotion and Protection of Investments’ (1982) 52 *British Yearbook of International Law* 241, 246.

<sup>34</sup> Schreuer (n. 32), 251.

<sup>35</sup> *SGS Société Générale de Surveillance SA v Islamic Republic of Pakistan* (Decision on Jurisdiction, 6 August 2003) ICSID Case No ARB/01/13.

<sup>36</sup> Katherine Jonckheere, ‘Practical Implications from an Expansive Interpretation of Umbrella Clauses in International Investment Law’ (2015) 11 *South Carolina Journal of International Law and Business* 143, 146.

clauses have been subject to significant debate by tribunals and scholars.<sup>37</sup> This has led to two divergent approaches to the interpretation of umbrella clauses, namely a restrictive and an expansive interpretation.<sup>38</sup>

## I. Restrictive Interpretation

In a line of ICSID cases umbrella clauses have been interpreted in a restrictive manner. The first and perhaps the most famous of these cases is *SGS v Pakistan*. SGS had signed a contract with Pakistan which included a forum selection clause establishing the Pakistan courts as the forum for contractual disputes. The BIT signed between Pakistan and Switzerland contained an umbrella clause which stated that “[e]ither 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”.<sup>39</sup> The Tribunal did not agree with the Swiss claimant’s assertion that the umbrella clause transformed breaches of the obligations contained in the contract to breaches of the BIT: “[t]he 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 are automatically elevated to the level of breaches of international treaty law”.<sup>40</sup>

The Tribunal’s rejection of SGS’s argument appears to have been motivated by the consequences of a broad approach. The Tribunal held that the effects of an expansive interpretation would be “so far-reaching in scope and so burdensome in their potential impact on the State” that without clear indication that the parties had accepted such consequences the Tribunal would not enforce such a result.<sup>41</sup> It explained that if it were to accept that the clause could transform contractual violations into violations of the treaty itself, without an apparent indication that the states had envisioned the clause to do so, this would produce several outcomes, and proceeded to explain some

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<sup>37</sup> Yannaca-Small (2006) (n. 19), 22.

<sup>38</sup> İlyas Gölcüklü, ‘Umbrella Clauses in ICSID Arbitration’ (2018) 37 Public and Private International Law Bulletin 352, 360.

<sup>39</sup> Pakistan–Switzerland BIT (1995), Art. 11 <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2130/download>> accessed 2 August 2019

<sup>40</sup> *SGS v Pakistan* (n. 35), para. 166.

<sup>41</sup> *Ibid*, para. 167.

of these. Firstly, an expansive application of the umbrella clause would lead to every legal instrument in which the state had undertaken commitments towards the investor being incorporated in the BIT, and therefore any breach of these instruments by the state would cause a breach of the BIT. Secondly, if adopted, the view of the claimant would result in the other obligations contained in the BIT becoming superfluous, because the claimant would not need to establish a violation of them; a breach of the contract would be enough to establish a breach of the treaty. Thirdly, the investor would have the power to nullify the forum selection clause of the contract by opting for the dispute settlement mechanisms specified in the treaty.<sup>42</sup>

Another restrictive interpretation was undertaken in *El Paso v Argentina*.<sup>43</sup> Article II(2)(c) of the applicable BIT stated that “[e]ach Party shall observe any obligation it may have entered into with regard to investments”.<sup>44</sup> In coming to a decision the Tribunal borrowed heavily from the arguments in *SGS v Pakistan*, and stated that the “arguments put forward by the Tribunal are, in the view of this Tribunal, more than conclusive”.<sup>45</sup> It reinforced the floodgates claim and specifically endorsed the argument of the Tribunal in *SGS v Pakistan* that an expansive interpretation would render all other substantive provisions of the BIT useless.<sup>46</sup>

However, the Tribunal diverged from *SGS v Pakistan* in drawing a distinction “between the state as a merchant and the state as a sovereign”.<sup>47</sup> It stated that the clause should not apply to state breaches of a simple commercial contract; rather, the clause should only cover breaches of contractual obligations in which the state had acted “as a sovereign” and the Tribunal cited the example of a stabilization clause.<sup>48</sup> Essentially, it endeavoured to balance the interests of the parties by espousing a balanced approach to interpretation: “[t]his Tribunal considers that a balanced interpretation is needed, taking into account both State sovereignty and the State's responsibility to

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<sup>42</sup> Ibid, para. 168.

<sup>43</sup> *El Paso Energy International Company v The Argentine Republic* (Decision on Jurisdiction, 27 April 2006) ICSID Case No ARB/03/15.

<sup>44</sup> Argentina–United States of America BIT (1991) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/127/download>> accessed 2 August 2019.

<sup>45</sup> *El Paso v Argentina* (n. 43), para. 71.

<sup>46</sup> Ibid, paras 72–4.

<sup>47</sup> Dolzer and Schreuer (n. 31), 173.

<sup>48</sup> *El Paso v Argentina* (n. 43), para. 81.

create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow”.<sup>49</sup>

## II. Expansive Interpretation

In several cases, ICSID Tribunals have interpreted an umbrella clause expansively and thus given “full effect” to such clauses.<sup>50</sup> Such an interpretation can be seen in *Noble Ventures v Romania*,<sup>51</sup> in which the Tribunal analyzed Article II(2)(c) of the Romania–USA BIT.<sup>52</sup> This states that “[e]ach Party shall observe any obligation it may have entered into with regard to investments”. The claimant had put forward the argument that the umbrella clause had been breached because Romania had failed to stand by its contractual commitments.<sup>53</sup>

The Tribunal found it necessary to interpret the clause by referring to Article 31 of the Vienna Convention on the Law of Treaties (VCLT), which it emphasized reflects customary international law.<sup>54</sup> The Tribunal made use of the interpretative techniques contained in Article 31 of the VCLT and emphasized the “object and purpose” of the treaty.<sup>55</sup> Interpreting the wording of the clause, it highlighted that the parties had used the word “shall” and that “there can be no doubt that the Article was intended to create obligations, and obviously obligations beyond those specified in other provisions of the BIT itself”.<sup>56</sup>

In the view of the Tribunal, the inclusion of the umbrella clause in the treaty by the parties indicated that their intention had been to elevate contractual obligations to the realm of treaty obligations.<sup>57</sup> Consequently, the Tribunal held that an umbrella clause, if introduced to a BIT, brings about an exception to the customary rule of a separation

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<sup>49</sup> *Ibid*, para. 70.

<sup>50</sup> Dolzer and Schreuer (n. 31), 169.

<sup>51</sup> *Noble Ventures, Inc v Romania* (Award, 12 October 2005) ICSID Case No ARB/ 01/11.

<sup>52</sup> Romania–United States of America BIT (1992) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2221/download>> accessed 2 August 2019.

<sup>53</sup> *Noble Ventures v Romania* (n. 51), para. 38.

<sup>54</sup> *Ibid*, para. 50.

<sup>55</sup> *Ibid*, para. 52.

<sup>56</sup> *Ibid*, para. 51.

<sup>57</sup> *Ibid*, para. 61.

between the obligations of a state under its municipal law and its obligations in the international realm.<sup>58</sup> The approach taken by the Tribunal appealed to the object and purpose of the treaty in question to support its expansive reading.<sup>59</sup> It did not restrict the scope of the clause in any manner and did not rule on the question of whether the effects of the clause could be restricted.<sup>60</sup>

The Tribunal in *SGS v Philippines* also interpreted an umbrella clause in an expansive manner and thereby gave it full effect.<sup>61</sup> It examined Article X(2) of the BIT between the Philippines and Switzerland,<sup>62</sup> which expressed 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”. As in *Noble Ventures v Romania*, the Tribunal came to the conclusion that a breach of the obligations contained in the agreement with SGS would also result in a breach of the investment treaty by holding that “Article X(2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments”.<sup>63</sup> However, it did not incorporate this attitude into its conclusion. Instead, it concluded that the clause could not abrogate the expressly stated forum.<sup>64</sup> As observed by Wong, “this is to take away with one hand what was given with the other, leaving investors no less empty-handed than they were under *SGS v Pakistan*”.<sup>65</sup>

Adding to the confusion regarding the applicability of umbrella clauses in circumstances in which the contract encompasses an exclusive forum selection clause, a number of Tribunals have held that an exclusive forum selection clause does

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<sup>58</sup> *Ibid*, para. 55.

<sup>59</sup> Stephan W Schill, ‘Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties’ (2009) 18 *Minnesota Journal of International Law* I, 9.

<sup>60</sup> *Noble Ventures v Romania* (n. 51), para. 61.

<sup>61</sup> *SGS Société Générale de Surveillance, SA v The Republic of the Philippines* (Decision on Jurisdiction, 29 January 2004) ICSID case No ARB/02/6.

<sup>62</sup> Philippines–Switzerland BIT (1997) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2174/download>> accessed 2 August 2019.

<sup>63</sup> *SGS v Philippines* (n. 61), para. 128.

<sup>64</sup> *Ibid*, para. 155.

<sup>65</sup> Jarrod Wong, ‘Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide between Developing and Developed Countries in Foreign Investment Disputes’ (2006) 14 *George Mason Law Review* 135, 165–6.

not necessarily imply that the selected forum will adjudicate the matter and that the dispute settlement provisions contained in the BIT may displace the forum.<sup>66</sup> In *Eureko v Poland*,<sup>67</sup> the Tribunal held that it had jurisdiction to hear the contractual violation case even though the applicable BIT<sup>68</sup> contained an exclusive forum selection clause.<sup>69</sup> Similarly, in *LG&E Energy Corp v Argentina*,<sup>70</sup> the Tribunal did not address whether the forum selection clause should supersede the dispute settlement provisions contained in the BIT but instead proceeded to examine whether the contractual obligations had been breached.<sup>71</sup>

### III. Inconsistent Interpretation and Whether to Include an Umbrella Clause

The cases discussed above do not seem to offer sufficient guidance concerning the proper scope of umbrella clauses. Because international arbitration does not have a doctrine of binding precedent, these inconsistencies in interpretation are likely to continue.<sup>72</sup> In *SGS v Philippines* the Tribunal itself pointed out that it did not have to follow the interpretative approach adopted by the Tribunal in *SGS v Pakistan*.<sup>73</sup> Although it has been argued that a consensus has been developing regarding when an umbrella clause may apply to contractual commitments, in a system without binding precedents it will be difficult to guarantee a consistent approach to the interpretation of umbrella clauses.<sup>74</sup> Another reason which exacerbates the inconsistency in interpretation is the fact that the wording of the clause varies from treaty to treaty.<sup>75</sup>

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<sup>66</sup> Jonckheere (n. 36), 157.

<sup>67</sup> *Eureko BV v Republic of Poland* (Partial Award, 19 August 2005) 12 ICSID Reports 335.

<sup>68</sup> Netherlands–Poland BIT (1992) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2074/download>> accessed 2 August 2019.

<sup>69</sup> *Eureko v Poland* (n. 67), paras 190–91.

<sup>70</sup> *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentina* (Decision on Liability, 3 October 2006) ICSID Case no ARB/02/1.

<sup>71</sup> *Ibid*, paras 170–71.

<sup>72</sup> Gabrielle Kaufmann-Kohler, 'Arbitral Precedent: Dream, Necessity or Excuse?: The 2006 Freshfields Lecture' (2007) 23 *Arbitration International* 357, 378.

<sup>73</sup> *SGS v Philippines* (n. 61), para. 97.

<sup>74</sup> Jude Antony, 'Umbrella Clauses Since *SGS v Pakistan* and *SGS v Philippines* – A Developing Consensus' (2013) 29 *Arbitration International* 607, 638.

<sup>75</sup> Raúl H Pereira de Souza Fleury, 'Treaty-Protected Investment Agreements: Of Umbrella Clauses and Privity of Contract' (2016) 23 *Willamette Journal of International Law and Dispute Resolution* 319, 325.

## a) A Divide Between Developed and Developing Countries

One line of reasoning which, if accepted, could explain the impact of inconsistent interpretation on the decision of a state to incorporate the clause into its investment treaties is that developed countries aim to interpret such clauses expansively because foreign investors are usually from developed countries and the host state is typically a developing country; conversely, developing countries prefer a restrictive interpretation.<sup>76</sup> Notably, following the *SGS v Pakistan* award, the Swiss Secretariat for Economic Affairs sent a letter to the ICSID Secretariat stating that they were “alarmed about the very narrow interpretation given to the meaning of Article 11 by the Tribunal”.<sup>77</sup>

Developing countries, in an attempt to attract foreign investment, have traditionally bid away their concessions and entered agreements that contain broad provisions protecting foreign investors and investments.<sup>78</sup> As Shany notes, “the conflicting jurisprudence of ICSID tribunals over these issues cannot be attributed to the relatively minor textual differences between the BITs applicable to those cases but, rather, to an ideological chasm”.<sup>79</sup>

Likewise, Walde has argued that this ideological struggle concerning the interpretation of umbrella clauses is a struggle between ideologies emphasizing “state sovereignty” and others stressing the need for a strong “international commerce”.<sup>80</sup> The disagreements conceptualized, in this manner, reflect the proposition that inconsistent interpretation of the clause reflects the tension between developed and developing countries.<sup>81</sup>

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<sup>76</sup> Wong (n. 65), 138.

<sup>77</sup> Emmanuel Gaillard, ‘Investment Treaty Arbitration and Jurisdiction over Contract Claims – the SGS Cases Considered’ in Todd Weiler (ed.), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May, 2005), 341.

<sup>78</sup> Olivia Chung, ‘The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration’ (2006) 47 *Vanderbilt Journal of International Law* 953, 962.

<sup>79</sup> Yuval Shany, ‘Contract Claims vs. Treaty Claims: Mapping Conflicts Between ICSID Decisions on Multisourced Investment Claims’ (2005) 99 *American Journal of International Law* 835, 848.

<sup>80</sup> Thomas W Walde, ‘The Umbrella Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases’ (2005) 6 *Journal of World Investment & Trade* 183, 184.

<sup>81</sup> Wong (n. 65), 138.

During the negotiation of BITs, developing countries may have been eager to bind themselves to broad provisions, but it may be now becoming apparent that these standards might be more dangerous than was anticipated.<sup>82</sup> Those developing countries that are now in a position to do so could be preparing to drop umbrella clauses from their new-generation BITs.

However, this does not mean that applying an umbrella clause to purely commercial disputes is a concern for developing countries only. For example, Norway has not included an umbrella clause in its updated model BIT,<sup>83</sup> and this choice could be explained by the following comments by the government of Norway on the model BIT of 2007:

[t]he point of departure for the work on a new model agreement has been that the Arbitration Tribunal shall only be able to consider alleged breaches of the standards in the interstate investment agreement. Therefore, no right is laid down in the model agreement for an investor to use the same arbitration tribunal to settle disputes arising out of a contractual relationship between an investor (or his investment) and the host country.<sup>84</sup>

This commentary can be considered an indication of the key concern regarding umbrella clauses: whether they elevate contractual obligations into the realm of international treaty protection.<sup>85</sup> Likewise, Alvarez argues that the changing outlook of the United States towards broad investment protection is primarily due to the possibility of facing an increasing number of claims from foreign investors, and notes that other developed countries such as Canada are responding in a similar fashion.<sup>86</sup>

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<sup>82</sup> Chung (n. 78), 962.

<sup>83</sup> Draft Agreement between the Kingdom of Norway and ... for the Promotion and Protection of Investments (2015)

<<https://www.regjeringen.no/contentassets/e47326b61f424d4c9c3d470896492623/draft-model-agreement-english.pdf>> accessed 2 August 2019.

<sup>84</sup> Government of Norway, 'Comments on the Model for Future Investment Agreements' (English Translation of 19 December 2007), 29 <<https://www.italaw.com/sites/default/files/archive/ita1029.pdf>> accessed 2 August 2019.

<sup>85</sup> de Souza Fleury (n. 12).

<sup>86</sup> José E Alvarez, 'The Return of the State' (2011) 20 Minnesota Journal of International Law 223, 261.

Moreover, the argument that the disagreement over the interpretation of umbrella clauses is a conflict between developed and developing countries might not hold true today. While BITs have traditionally been signed between developing and developed countries, increasingly they are now being signed between two developing countries.<sup>87</sup> Today, BITs signed between developing countries represent around 40 per cent of all BITs, and more than 100 developing countries have signed investment treaties with other developing countries.

This trend started with the conclusion of the investment treaty between Kuwait and Iraq in 1964.<sup>88</sup> At the end of 1989, BITs concluded between developing countries only constituted 10 per cent of all current BITs; by the end of 1999, 26 per cent of all BITs had been signed between developing countries.<sup>89</sup> In 2018, thirty BITs were concluded, and eight of these were concluded by Turkey while six were concluded by the United Arab Emirates.<sup>90</sup> This trend can be explained by increases in “outward foreign direct investment” (OFDI) flows from developing countries since the 1990s.<sup>91</sup> The OFDI from developing country firms accounted for only 4 per cent of “foreign direct investment” (FDI) in 1995 and rose to nearly 20 per cent in 2015.<sup>92</sup>

Furthermore, the reasoning that umbrella clauses should be interpreted restrictively to protect developing countries also contains some contradictions and inconsistencies. Firstly, it could be claimed that including an umbrella clause in a treaty helps the developing state attract more FDI by permitting investors to apply to a neutral tribunal to resolve investment disputes. Secondly, if accepted such an argument could be

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<sup>87</sup> Matthew W Barrier, 'Regionalization: The Choice of a New Millennium' (2000) 9 *Currents: International Trade Law Journal* 25, 27.

<sup>88</sup> Lauge Skovgaard Poulsen, 'The Politics of South–South Bilateral Investment Treaties' in Amelia Porges, Marc L Busch and Tomer Broude (eds), *The Politics of International Economic Law* (Cambridge University Press, 2011), 186.

<sup>89</sup> UNCTAD, 'Bilateral Investment Treaties 1959–1999' (2000) UNCTAD/1TE/IIA/2, 4.

<sup>90</sup> UNCTAD (2019b) (n. 7), 99.

<sup>91</sup> UNCTAD, 'South–South Cooperation in International Investment Arrangements' (2005) 3.

<sup>92</sup> Jose Ramon Perea and Matthew Stephenson, 'Outward FDI from Developing Countries' *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications* (The World Bank 2017) 101 <[http://elibrary.worldbank.org/doi/10.1596/978-1-4648-1175-3\\_ch4](http://elibrary.worldbank.org/doi/10.1596/978-1-4648-1175-3_ch4)> accessed 2 August 2019.

raised to propose the invalidation of all treaty provisions since such a disparity in bargaining power is equally applicable to other provisions.<sup>93</sup>

Nonetheless, this argument cannot be readily brushed aside. As the possible consequences of their undertakings have started to become apparent, several countries have terminated old treaties and moved to negotiate for better substantive terms.<sup>94</sup> In 2017, the number of treaties terminated exceeded the number of new treaties for the first time.<sup>95</sup> The increase in terminations has also been attributed to the increased bargaining power of developing countries.<sup>96</sup>

Moreover, because umbrella clauses have not featured regularly in jurisprudence and scholarship until recently, the possible consequences of a broad interpretation might not have been readily apparent for most states before inconsistent interpretations started to emerge. States in a position to do so, especially those who have increased their bargaining power, might very well move to drop such broad clauses from their new-generation treaties.

As cases have proliferated, the investment arbitration system has also received backlash from developed countries,<sup>97</sup> and the dropping of umbrella clauses could also be explained by the desire of these countries to reduce the risk of being sued by investors. Furthermore, the concern which led to the adoption of umbrella clauses, i.e. investors' fear of having to deal with underdeveloped legal systems in host states, might not be so prevalent today, and therefore it may not be as necessary as before to include an umbrella clause.<sup>98</sup>

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<sup>93</sup> Wong (n. 65), 139.

<sup>94</sup> Yoram Z Haftel and Alexander Thompson, 'When Do States Renegotiate Investment Agreements? The Impact of Arbitration' (2018) 13 *The Review of International Organizations* 25, 26.

<sup>95</sup> UNCTAD, 'Recent Developments in the International Investment Regime' (2018a) IIA Issues Note, No. 1, 2.

<sup>96</sup> Tuuli-Anna Huikuri, 'Terminating to Renegotiate: Bargaining in the Investment Treaty Regime' (The Political Economy of International Organization, Salzburg, 8 February 2019) 10 <[https://www.peio.me/wp-content/uploads/2019/01/PEIO12\\_Paper\\_52.pdf](https://www.peio.me/wp-content/uploads/2019/01/PEIO12_Paper_52.pdf)> accessed 2 August 2019.

<sup>97</sup> Malcolm Langford, Daniel Behn and Ole Kristian Fauchald, 'Backlash and State Strategies in International Investment Law', in Tanja Aalberts and Thomas Gammeltoft-Hansen (eds), *The Changing Practices of International Law* (Cambridge University Press, 2018), 72.

<sup>98</sup> Marc Jacob, 'International Investment Agreements and Human Rights' [2010] INEF Research Paper Series on Human Rights, Corporate Responsibility and Sustainable Development 1, 20.

## b) Flood of Commercial Claims

Another factor that could possibly influence state choices regarding inclusion is the floodgates argument.<sup>99</sup> As established above, investment tribunals have frequently emphasized the floodgates argument when undertaking a restrictive interpretation. It is held that, if given effect by means of an expansive approach, investors might be encouraged to bring cases against states for minor contractual breaches.<sup>100</sup>

However, it has also been argued that it is very unlikely that investors would resort to investment arbitration by bringing claims for minor breaches, since international investment arbitration is very expensive.<sup>101</sup> Another factor that weighs against the floodgates argument is that the investor would not be able to pursue every commercial breach before an ICSID Tribunal because the jurisdictional requirements of the ICSID Convention only permit disputes concerning “investment-related contracts” to be referred to the Tribunal.<sup>102</sup>

Crawford also notes that “[t]he characterization of a claim as contractual or otherwise is essentially a matter of technique and bears no relation to the frequency or otherwise with which investment disputes arise and are submitted to arbitration”.<sup>103</sup> Another line of reasoning opposing the floodgates argument is the fact that, despite the large number of BITs and high level of FDI, the number of claims brought using umbrella clauses has been “insignificant”.<sup>104</sup>

Nevertheless, the arguments opposing the notion of a state being exposed to a flood of cases might not be enough to suppress the concerns arising from an expansive

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<sup>99</sup> Yarik Kryvoi, ‘Counterclaims in Investor-State Arbitration’ (2011) LSE Legal Studies Working Paper No. 8/2011, 29.

<sup>100</sup> Jonathan B Potts, ‘Stabilizing the Role of Umbrella Clauses in Bilateral Investment Treaties: Intent, Reliance, and Internationalization’ (2010) 51 *Vanderbilt Journal of International Law* 1005, 1029.

<sup>101</sup> Elvira R Gadelshina, ‘Hermeneutic Reflections on the Specific Purpose of Umbrella Clauses’ (2013) 14 *The Journal of World Investment & Trade* 804, 820.

<sup>102</sup> Schill (n. 59), 33.

<sup>103</sup> James Crawford, ‘Treaty and Contract in Investment Arbitration’ (2014) 24 *Arbitration International* 351, 369.

<sup>104</sup> John P Gaffney and James L Loftis, ‘The Effective Ordinary Meaning of BITs and the Jurisdiction of Treaty-Based Tribunals to Hear Contract Claims’ (2007) 8 *Journal of World Investment & Trade* 5, 21.

approach to interpreting umbrella clauses. The risk of being exposed to the domestic courts of developing countries that lack a stable legal environment is precisely what the BIT aims to limit.<sup>105</sup>

Between 1987 and 31 July 2017, investors alleged that umbrella clauses had been breached in 114 cases, while the number of cases in which investors alleged that a national treatment provision had been breached was 111.<sup>106</sup> This demonstrates that invocation of umbrella clauses is not exceptionally rare, and states might not perceive the number of claims as insignificant.

Furthermore, two developing countries (Argentina and Venezuela) were the most frequent respondents between 1987 and 2016.<sup>107</sup> Adding to the risk of developing countries being exposed to claims in commercial disputes is the fact that the old-generation BITs of developed countries often contain an umbrella clause, more specifically the four countries that have concluded the most BITs that contain umbrella clauses are Germany, the United Kingdom, Switzerland and the Netherlands.<sup>108</sup>

States wishing to evade some of the consequences of stemming from an expansive approach, in particular, may wish to adopt some of the reform options suggested by UNCTAD rather than simply drop the clause from their BITs. These options can resolve some of the most prevalent anxieties of states, especially the floodgates argument. For example, an umbrella clause could state that it only applies to acts that stem from an exercise of sovereign power by the government. Another option is to deny the use of dispute settlement options contained in the BIT to claims alleging breach of an umbrella clause.<sup>109</sup>

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<sup>105</sup> Carlos G Garcia, 'All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration' (2004) 16 Florida Journal of International Law 301, 307.

<sup>106</sup> UNCTAD, 'Special Update on Investor-State Dispute Settlement: Facts And Figures [IIA Issues Note, No. 3, 2017]' (2017a), 6.

<sup>107</sup> Ibid, 3.

<sup>108</sup> UNCTAD Investment Policy Hub IIA Mapping Project (n. 18).

<sup>109</sup> UNCTAD (2018b) (n. 5), 42.

### 3: UMBRELLA CLAUSES and the RIGHT to REGULATE

#### I. The Move Towards Greater Policy Space

The recent increases in the number of IIAs and investment disputes have emphasized the possible conflict between a state's duty towards investors under treaties, and its right to regulate.<sup>110</sup> The concern is that provisions in investment treaties will prevent a state from adopting regulations that it perceives to be for the benefit of the public.<sup>111</sup> States are now assessing the “amount of sovereign policy space” they have given up by signing investment treaties.<sup>112</sup> Owing to these concerns both developing and developed states have been re-evaluating their investment treaties since the 2000s.

The criticism of existing BIT regimes by countries of the Global South started to grow after cases were brought against measures adopted by Argentina during its financial crisis. Asian countries such as India and Indonesia are also currently revisiting their old-generation BITs in order to protect themselves from cases initiated by investors.<sup>113</sup> The “investor-state dispute settlement system” (ISDS) received considerable backlash after Australia was forced to defend its packaging scheme. This was another case that demonstrated that investors could contest measures adopted by governments for the benefit of the public.<sup>114</sup> The Australian government was so frustrated over the incident that it declared that it would no longer incorporate ISDS provisions into its investment treaties.<sup>115</sup>

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<sup>110</sup> Suzanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13 *Journal of International Economic Law* 1037, 1038.

<sup>111</sup> Simon Lester and Bryan Mercurio, 'Safeguarding Policy Space in Investment Agreements' (2017) *IIEL Issue Brief* 12/2017.

<sup>112</sup> Alvarez (n. 86), 234.

<sup>113</sup> Kavaljit Singh and Burghard Ilge, 'Rethinking Bilateral Investment Treaties – Critical Issues and Policy Choices' [2016] New Delhi: Both Ends, Madhyam, Centre for Research on Multinational Corporations, 4–6.

<sup>114</sup> Vera Korzun, 'The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-Outs' (2017) 50 *Vanderbilt Journal of Transnational Law* 355, 356–7.

<sup>115</sup> Australian Government Department of Foreign Affairs and Trade, 'Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity' 14 <[http://blogs.usyd.edu.au/japaneselaw/2011\\_Gillard%20Govt%20Trade%20Policy%20Statement.pdf](http://blogs.usyd.edu.au/japaneselaw/2011_Gillard%20Govt%20Trade%20Policy%20Statement.pdf)> accessed 2 August 2019.

Old-generation treaties, which placed too much prominence on the rights of investors, are now being replaced by treaties that try to strike a balance between the rights of investors and the duties of the state. The objective is to safeguard a country's right to regulate public concerns. While this position was once espoused only by scholars, it is now being supported by some intergovernmental organizations.<sup>116</sup> For example, in its "Investment Policy Framework for Sustainable Development" report UNCTAD states that one of the options for countries seeking to achieve a suitable balance between investor protection and the right to regulate is clarification of "the scope and meaning of treaty provisions".<sup>117</sup> In its Reform Package, under the chapter "Safeguarding the right to regulate", UNCTAD specifically mentions umbrella clauses and states that they influence that right.<sup>118</sup> One of the options for safeguarding policy space cited by UNCTAD is to drop the umbrella clause from investment treaties.<sup>119</sup>

## **II. The Right to Regulate and Whether to Include an Umbrella Clause**

Although UNCTAD has stated that umbrella clauses can have an impact on a country's right to regulate, its reports do not provide any examples of how an umbrella clause could have such an effect. An examination of jurisprudence and scholarship presents certain possible instances.

### **a) Umbrella Clauses and Unilateral Acts**

For example, a state's right to regulate could be curtailed if the umbrella clause were to serve a function similar to a stabilization clause. Although, the clause would not be able to exclude all legislative or regulatory changes the state had undertaken, in such a case, the host state would have to comply with certain undertakings assumed towards the investor, even if no stabilization clause were present in the contract and state legislation did not afford such security. Through the umbrella clause, the investor

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<sup>116</sup> Peter Muchlinski, 'Negotiating New Generation International Investment Agreements', in Steffen Hindelang and Markus Krajewski (eds), *Shifting Paradigms in International Investment Law* (Oxford University Press, 2016), 41.

<sup>117</sup> UNCTAD (2015a) (n. 5), 8.

<sup>118</sup> UNCTAD (2018b) (n. 5), 33.

<sup>119</sup> UNCTAD (2019a) (n. 6), 2.

would be able to hold the state responsible for any undertakings it had entered before the state had enacted laws to which the investor objected.<sup>120</sup> Thus, the umbrella clause would apply to “commitments that a host State has entered into with regard to specific investments of an investor, or investments of a specific investor, which played a significant role in the investor’s decision to invest or to substantially change an existing investment, i.e. commitments which were of such a nature that the investor could rely on them”.<sup>121</sup> The umbrella clause would, therefore, function to protect the interests of the investor in cases in which a change in law resulted in frustrating specific undertakings provided to the investor by the state itself.<sup>122</sup>

Likewise, it has also been argued that an umbrella clause formulated in a broad manner, so that it provides that the state will observe any obligation towards an investor, might lead to the assumption that the clause covers not only contractual obligations but also unilateral obligations assumed by the state as a result of legislative or administrative actions.<sup>123</sup> For example, in its interpretation of the words “commitments it has entered into” the Tribunal in *SGS v Pakistan* found that “the commitments referred to may be embedded in, e.g., the municipal legislative or administrative or other unilateral measures of a Contracting Party”.<sup>124</sup>

Yannaca-Small also argues that there is sufficient support for the claim that broad language contained in an umbrella clause, such as “any obligation”, not only covers contractual commitments made by the state but could also apply to assurances or undertakings made by the state in other forms, such as legislation.<sup>125</sup> The obligation is clear enough when the contact is between the host state and the investor, but in the

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<sup>120</sup> Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press, 2017), 138.

<sup>121</sup> Note on the Interpretation of Article 11 of the Bilateral Investment Treaty between Switzerland and Pakistan in the Light of the Decision of the Tribunal on Objections to Jurisdiction of ICSID in Case No. ARB/01/13 *SGS Société Générale de Surveillance SA v Islamic Republic of Pakistan*, attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy-Secretary General dated 1 October 2003, published in 19 Mealey’s: International Arbitration Report E 3 (Feb. 2004).

<sup>122</sup> McLachlan, Shore and Weiniger (n. 120), 139.

<sup>123</sup> Katia Yannaca-Small, 'What About This "Umbrella Clause"?' in Katia Yannaca-Small (ed.), *Arbitration under International Investment Agreements: A Guide to the Key Issues* (Oxford University Press, 2010) 479, 497.

<sup>124</sup> *SGS v Pakistan* (n. 35), para. 166.

<sup>125</sup> Yannaca-Small (2010) (n. 123), 497.

absence of a contractual relationship, the umbrella clause will only apply to the extent that an obligation can be established by a specific commitment of the state. Therefore, general legislative measures could possibly be altered unilaterally without the state incurring liability because these measures would likely not be considered to be obligations “arising from a particular commitment”.<sup>126</sup>

Similarly, Schill claims that an obligation will be conveyed by an umbrella clause only if the commitment made by the state could serve as a “functional substitute” for a contract between the investor and the host state. To serve in such a capacity the commitment would have to be specific and a determination that the “legislative commitment is specific enough” would have to be scrutinised on a case-by-case basis. The commitment could be deemed specific if it grants the investor certain rights as an incentive to invest. So, if the legislative act in question is adopted in order to promote or incentivize foreign investment and the investor had relied upon such a commitment when it decided to invest in the host state, then the commitment could come under the scope of an umbrella clause.<sup>127</sup>

In describing the term “undertaking”, Lauterpacht states that a situation can amount to an undertaking even in the absence of a contractual relationship. The example he provides is a statement made by the host state assuring investors that they will receive a certain “standard of treatment”, on which the investor relies when conducting investment activities.<sup>128</sup>

Moreover, there are also arguments holding that an undertaking does not need to be specific to be protected by an umbrella clause, and that general undertakings can also fall within the scope of a clause. It is argued that as long as there is “sufficient connection” between the undertaking and the investment in question, a general undertaking will be covered by an umbrella clause.<sup>129</sup> Tribunals have also proclaimed

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<sup>126</sup> Mann (n. 33), 246.

<sup>127</sup> Schill (n. 59), 72.

<sup>128</sup> Eli Lauterpacht, ‘The Drafting of Treaties for the Protection of Investment’ (1962) 3 *International & Comparative Law Quarterly*, Supp. Pub. 18, 29.

<sup>129</sup> Andrew Paul Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International BV, 2009), 458.

that a state could be held liable under international law if a general measure transforms or obstructs an obligation assumed by the host state towards the investor. These findings have commonly been based on a broad understanding of the term “commitments” and have been used to protect investors from subsequent legal changes.<sup>130</sup>

The argument that an umbrella clause could cover more obligations than just contractual ones was confirmed by the Tribunal in *LG&E v Argentina*. Article II(2)(c) of the applicable BIT was worded broadly and provided that “[e]ach Party shall observe any obligation it may have entered into with regard to investments”. The Tribunal held that Argentina had breached the clause even though there was no contractual stabilization clause between it and the investor. The regulations in question were deemed specific enough to constitute obligations under the umbrella clause. The Tribunal noted that the state had “made these specific obligations to foreign investors” and publicized the guarantees in order to promote foreign investment, and therefore “by virtue of targeting foreign investors and applying specifically to their investments” the obligations came under the scope of the umbrella clause.<sup>131</sup>

Similarly, in *Enron v Argentina*, the Tribunal held that the umbrella clause covered not only obligations arising from the contract but also “obligations assumed through law or regulation”.<sup>132</sup> The Tribunal noted that by adopting the legislation, Argentina had intended to attract foreign capital and that the undertakings were adequately specific to be regarded as linked with the investments.<sup>133</sup> The ad hoc committees approach in *CMS v Argentina* differed from the approach taken by the Tribunals in *LG&E v Argentina* and *Enron v Argentina*.<sup>134</sup> The committee set up to consider the case held that the umbrella clause related to “consensual obligations arising independently of the BIT itself”.<sup>135</sup>

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<sup>130</sup> Lise Johnson and Oleksandr Volkov, ‘Investor-State Contracts, Host-State “Commitments” and the Myth of Stability in International Law’ (2013) 24 *American Review of International Arbitration* 361, 364.

<sup>131</sup> *LG&E v Argentina* (n. 70), para. 175.

<sup>132</sup> *Enron Corporation and Ponderosa Assets, LP v The Argentine Republic* (Decision On Jurisdiction, 14 January 2004) ICSID Case No Arb/01/3, para. 274.

<sup>133</sup> *Ibid*, paras 275–7.

<sup>134</sup> *CMS Gas Transmission Company v Argentine Republic* (Decision of the ad hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007) ICSID Case No ARB/01/8.

<sup>135</sup> *Ibid*, para. 95.

The Tribunals in *CMS* and *LG&E* had to examine the same Gas Law, which the Tribunal in *LG&E* found to be sufficiently specific to amount to an undertaking. This approach is at odds with the decision taken by the ad hoc committee, not because of its claim that legislation or regulations cannot be specific, but because such instruments cannot be held to be consensual and in the absence of a clear contractual stabilization clause would only compel the host state to comply with the requirements they set out if they are still in force.<sup>136</sup>

The decision in *LG&E v Argentina* has been criticized by some scholars. A legal opinion on the case held that “[i]t would be a startling proposition in any system of contract law that the regulatory system is a part of the contract” and that regulatory provisions do not constitute specific undertakings. The opinion also highlighted the consequences of such an approach by stating that assuming such an obligation would have devastating effects on a state’s sovereignty.<sup>137</sup>

Crawford also disagrees with the approach taken by the Tribunal in *LG&E v Argentina* concerning the impact of the umbrella clause. In his view, legislation or regulation ratified by the state, even if it is specific to the investor or investment, will not obligate the state to refrain from changing the law and that absent a specific stabilization clause the investor assumes the risk that the law may change.<sup>138</sup>

Likewise, the argument that an umbrella clause could have an effect on a state’s right to regulate is not accepted by Titi, who argues that, notwithstanding some countries’ recent reluctance to incorporate an umbrella clause in their treaties, these clauses do not affect a state’s capacity to legislate. However, she does note that countries which

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<sup>136</sup> Guillaume Borg and Jean-Christophe Honlet, ‘The Decision of the ICSID Ad Hoc Committee in *CMS v Argentina* Regarding the Conditions of Application of an Umbrella Clause: *SGS v Philippines* Revisited’ (2008) 7 *The Law & Practice of International Courts and Tribunals* 1, 18.

<sup>137</sup> *El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15 Legal Opinion of M. Sornarajah (2007), para. 96 <<https://www.italaw.com/sites/default/files/case-documents/ita0970.pdf>> accessed 2 August 2019.

<sup>138</sup> Crawford (n. 103), 370.

are concerned with preserving their policy space omit the clause from their new-generation treaties.<sup>139</sup>

## **b) Internationalization and Interplay with the FET Standard**

Even if it was accepted that an umbrella clause could not cover unilateral acts, still such a clause could indirectly disrupt a country's right to regulate and thereby restrict its policy space. For example, umbrella clauses could provide greater power to contractual stabilization clauses by granting them greater enforceability.<sup>140</sup> By applying an umbrella clause stabilization clauses would be internationalized and thereby could deter the state from adopting regulations to protect it from allegations of violation of an umbrella clause.<sup>141</sup> Long-term investment agreements often include a stabilization clause, and a broad interpretation of an umbrella clause could lead to "regulatory chill" for a prolonged period.<sup>142</sup> Another view is that by directly bolstering the protection provided to the investor, umbrella clauses might indirectly restrict the right to regulate by "strengthening the legitimate expectations of investors".<sup>143</sup>

Another matter which could be of concern for states is the possible convergence of an umbrella clause with the "Fair and Equitable Treatment" (FET) standard. The creation of a stable legal environment and the safeguarding of an investor's legitimate expectations are both principles of the FET standard.<sup>144</sup> A link between an umbrella clause and the FET standard could possibly be constructed by using the principle of safeguarding an investor's legitimate expectations.<sup>145</sup> It could be argued that adherence to such principles necessitates the observance of contractual undertakings by the host state.<sup>146</sup> Such a position, if accepted, would place all contractual

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<sup>139</sup> Aikaterini Titi, *The Right to Regulate in International Investment Law* (Nomos, 2014), 48–50.

<sup>140</sup> Cristina Bodea, Fangjin Ye and Andrew Kerner, 'Global Treaties and Domestic Politics: Do BITs Constrain Fiscal Policy in Developing Countries?' [2018] SSRN Electronic Journal 10 available at <<https://ssrn.com/abstract=3288100>>.

<sup>141</sup> *Ibid*, 3.

<sup>142</sup> Singh and Ilge (n. 113), 3.

<sup>143</sup> Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (Routledge, 2016), 204.

<sup>144</sup> Dolzer and Schreuer (n. 31), 145.

<sup>145</sup> Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press, 2008), 196.

<sup>146</sup> Rumana Islam, 'Interplay between Fair and Equitable Treatment (FET) Standard and Other Investment Protection Standards' (2014) 14 *Bangladesh Journal of Law* 117, 133.

obligations the state has assumed towards the investor within the scope of the FET standard and would thus render an umbrella clause superfluous.<sup>147</sup> A number of Tribunals have held that a breach of contractual obligations may lead to a violation of the FET standard.

The Tribunal in *Mondev* held that “a governmental prerogative to violate investment contracts would appear to be inconsistent with the principles embodied in Article 1105 and with contemporary standards of national and international law concerning governmental liability for contractual performance”.<sup>148</sup> Likewise, in *SGS v Paraguay* the Tribunal held that breach of a contractual obligation by the state, in this case, non-payment, could result in a breach of the FET standard.<sup>149</sup> However, the Tribunal did restrict the scope of the FET standard by stating that a breach would be found if, for example, a lack of payment “amounts to a repudiation of the contract, frustration of its economic purpose, or substantial deprivation of its value”.<sup>150</sup>

Other Tribunals have not granted the FET standard such broad scope. In *Impregilo v Pakistan*, the Tribunal found that the claimant could not rely on the FET standard unless it was proved that the contract had been breached as a result of misuse of public authority.<sup>151</sup> Similarly, in *Bayindir v Pakistan* the Tribunal held that a breach of the FET standard necessitated state actions that arose from the use of its sovereign powers.<sup>152</sup>

It is not likely that a broad approach which treats every violation of contractual obligations as a breach of the FET standard will prevail. However, it may be difficult to draw a line with certainty when it comes to the principle of an investor’s legitimate

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<sup>147</sup> CH Schreuer, ‘Fair and Equitable Treatment (FET): Interactions with Other Standards’ (2007) 4 *Transnational Dispute Management* 18.

<sup>148</sup> *Mondev International Ltd v United States of America* (Award, 11 October 2002) ICSID Case No ARB(AF)/99/2, para. 134.

<sup>149</sup> *SGS Société Générale de Surveillance SA v The Republic of Paraguay* (Decision on Jurisdiction, 12 February 2010) ICSID Case No ARB/07/29.

<sup>150</sup> *Ibid*, para. 146.

<sup>151</sup> *Impregilo SpA v Islamic Republic of Pakistan* (Decision on Jurisdiction, 22 April 2005) ICSID Case No ARB/03/3, paras 266–70.

<sup>152</sup> *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan* (Award, 27 August 2009) ICSID Case No ARB/03/29, para. 377.

expectations.<sup>153</sup> Owing to inconsistent interpretation by ICSID tribunals concerning this matter, a state could face the risk of being confronted by numerous claims that breach of an umbrella clause would also be a breach of the FET standard. A host state might hesitate to legislate if the legislation in question could be held to be a breach of contractual obligations. Furthermore, even if a standard based on sovereign acts is accepted, a clear distinction between different types of state actions might not be possible; and even if the acts were of a commercial nature, the motives of the state might not be.<sup>154</sup>

### **c) Implications and Options**

Overall, states should take notice of the fact that they might be held responsible under an umbrella clause for unilateral assertions or regulatory measures. The practice of ICSID tribunals has demonstrated that the application of an umbrella clause to undertakings adopted unilaterally by states is “overwhelmingly” accepted. This function of the umbrella clause might unduly restrict the policy space of states because, if worded in a general or broad manner, the umbrella clause might apply to every obligation taken on by the host state, irrespective of whether the obligation in question is contained in a legislative document or mutual contract.<sup>155</sup>

An umbrella clause could also internationalize stabilization clauses contained in contracts and grant them further enforceability, and thereby expose the state to costly arbitration proceedings. Faced with such a risk the host state might hesitate to adopt regulations in the public interest if this entailed being subject to international proceedings. Moreover, a tribunal might find that breach of an umbrella clause simultaneously resulted in breach of the FET standard and therefore the state might be forced to defend against two lines of action, which would probably result in it

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<sup>153</sup> Schreuer (n. 147), 20.

<sup>154</sup> Dolzer and Schreuer (n. 31), 154.

<sup>155</sup> Maria Cristina Gritón Salias and María Cristina, ‘Do Umbrella Clauses Apply to Unilateral Undertakings?’ in Christina Binder, Ursula Kriebaum, August Reinisch, and Stephan Wittich (eds), *International Investment Law for the 21 st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press, 2009), 495–6.

incurring further costs. Confronted with such a prospect, a state might very well be reluctant to adopt regulations that might cause an ordinary breach of the contract.

These concerns were pointed out by the European Parliament. Bernd Lange, Chair of the European Parliament's International Trade Committee, shared his disapproval of the presence of an umbrella clause in the EU proposal for an ISDS mechanism in the Transatlantic Trade and Investment Partnership. Lange cautioned that the inclusion of an umbrella clause "can have an important negative impact on the right to regulate".<sup>156</sup>

States could elect to clarify the scope of the umbrella clause in order to avoid some of the consequences mentioned in this section. For example, some Chinese BITs explicitly signify that the umbrella clause applies to contractual obligations.<sup>157</sup> This could be interpreted as a policy choice to limit the umbrella clause to covering only contractual commitments and thereby exclude host state obligations contained in legislation or regulations.<sup>158</sup> Similarly, another example of states choosing to clarify the scope of an umbrella clause can be observed in Article 8 of the Iceland–Mexico BIT,<sup>159</sup> which states that "[e]ach Contracting Party shall observe any other obligation it has assumed in writing". Unilateral written obligations are excluded from the scope of the clause because in its second sentence the Article provides that "disputes arising from such obligations shall be settled only under the terms of the contracts underlying the obligations".

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<sup>156</sup> EU Trade Insights, 'Lange Gives Mixed Blessing to Commission's Final ICS Proposal' <<http://www.borderlex.eu/eutradeinsights/lange-gives-mixed-blessing-to-commissions-final-ics-proposal/index.html>> accessed 2 August 2019.

<sup>157</sup> See Art. 9 of the China–Jordan BIT (2001) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/748/download>> accessed 2 August 2019.

<sup>158</sup> Dulac (n. 23), 18.

<sup>159</sup> Iceland–Mexico BIT (2005) <<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1562/download>> accessed 2 August 2019.

## CONCLUSION

This paper has examined the reasons espoused by some states and UNCTAD for not including umbrella clauses in new-generation BITs. In the first section, the widespread trend towards excluding such clauses is demonstrated through the examination of recent state practice.

Having accepted that such a trend is indeed under way, in the second section this paper analysed the inconsistent interpretation of umbrella clauses by ICSID tribunals and scrutinised the consequences of these interpretative methods. It demonstrated that while there are arguments against the possible effects of such methods, it is reasonable that states now in a position to do so might want to exclude such broad clauses. It is emphasized that umbrella clauses originated to protect investors from predominantly developed countries and could now result in both developing and developed countries facing the possibility of numerous international claims by investors.

In the final section, this paper explored the possible effects of umbrella clauses on a state's right to regulate. The possibility that such a clause might apply to unilateral undertakings and general legislation presents the greatest risk for states. The scope for internationalizing any stabilization clause in the contract and the potential interplay between the FET standard and umbrella clauses can also indirectly limit a state's right to regulate by exposing the state to the risk of costly international claims.

It can be concluded that an umbrella clause may present a risk for states because it can place constraints on the right to regulate and expose the state to the risk of numerous international proceedings pursuing contractual claims. Rather than not including an umbrella clause, states that wish to avoid some of these risks also have the option to clarify its scope or exclude particular dispute settlement options for claims arising out of it.

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