Hakemli Araştırma Makalesi/Peer - Reviewed Research Article

ENFORCEABILITY OF UMBRELLA CLAUSES BY INVESTMENT ARBITRATION TRIBUNALS

Şemsiye Klozların Yatırım Tahkim Mahkemeleri Tarafından Uygulanabilirliği

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ABSTRACT

Over the last few decades, one of the most contentious issues of the international investment law has been the interpretation of the 'umbrella clauses'. Since the umbrella clauses are generally vague, short and hidden in international investment agreements, the interpretation of the clause is in a controversial position and thereby having been subject to the scholarly interest. Should umbrella clauses in international investment agreements be

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enforceable by arbitration tribunals? Or to what extent investor's claims stemming from a contractual breach could be enforceable by arbitration tribunals? *SGS v Pakistan* and *SGS v Philippines* have addressed these questions and reached opposite decisions. This article aims to examine the contradictory arbitral decisions and to discuss broad and restrictive approaches. The article begins with a brief review of umbrella clauses. Then, it analyses leading arbitral cases with the help of scholar views in order to shed the light on critical aspects of the issue.

Keywords: Umbrella clauses, foreign investment, foreign investor, investment arbitration, international investment agreement

ÖZET

Son birkaç on yılda, uluslararası yatırım hukukunun en tartışmalı konularından biri, 'şemsiye klozların' yorumlanması olmuştur. Uluslararası yatırım anlaşmalarında şemsiye klozlar genellikle muğlak, kısa ve gizli olduğundan, klozun yorumlanması tartışmalıdır ve bu nedenle akademik ilgiye konu olmuştur. Uluslararası yatırım anlaşmalarındaki şemsiye klozlar, tahkim mahkemeleri tarafından uygulanabilir olmalı mıdır? Ya da, yatırımcının sözleşme ihlalinden kaynaklanan iddiaları, tahkim mahkemeleri tarafından ne ölçüde uygulanabilir? *SGS v Pakistan* ve *SGS v Philippines* davaları bu soruları ele almışlar ve karşıt kararlara varmışlardır. Bu makale, çelişkili tahkim kararlarını incelemeyi ve geniş ve sınırlayıcı yaklaşımları tartışmayı amaçlamaktadır. Makale, şemsiye klozların kısa bir incelemesi ile başlamaktadır. Ardından, konunun kritik yönlerine ışık tutmak için önde gelen tahkim davalarını akademik görüşler yardımıyla analiz etmektedir.

Anahtar kelimeler: Şemsiye klozlar, yabancı yatırım, yabancı yatırımcı, yatırım tahkimi, uluslararası yatırım anlaşması

INTRODUCTION

Where a host state does not perform its contractual obligations to a foreign investor, the investor can bring a claim against the host state for breach of contract. From a traditional standpoint, investors can pursue their claims before the domestic courts of host state. However, this perception has been changed by means of umbrella clauses in international investment agreements so as to give protection to the investor.

Umbrella clauses are critical and obviously contentious. In this respect, whereas some international tribunals and scholars interpret the clauses broadly, some others interpret them restrictively.

This article will endeavour to answer the questions whether umbrella clauses in international investment agreements should be enforceable by arbitration tribunals, and whether a state should include an umbrella clause. In order to answer these questions, this article will attempt to examine the contradictory decisions rendered by the international tribunals by beginning with the meaning and a brief review of umbrella clauses. Broad approach and restrictive approach will be attempted to be discussed in light of wide range of leading cases. The article will then analyse the questions critically, trying to trace a logical path, and assessing crucial aspects of the issue.

I. MEANING

Traditionally, investment arbitration has not incorporated contractual claims.[1] In other words, when a state breaches a private contract, this generally will not lead to direct international liability on the state. Foreign investors have been nervous about entering foreign countries which might include a prejudiced and extremely slow

[1] Krista Nadakavukaren Schefer, International Investment Law: Text, Cases and Materials, (Cheltenham, UK, Northampton, MA, USA: Edward Elgar Publishing Second Edition 2016), 503.

domestic judicial system.[2] However, umbrella clauses have elevated a breach of private contract to the stage of an international treaty violation, and have changed the traditional perception. They grant foreign investment international remedies even in case of breach of contract.[3] It is generally accepted that the aim of the umbrella clauses is to add extra protection to the foreign investor.[4] The protection of investor-state contracts has become a standard clause in bilateral investment agreements.[5] Investment agreements generally include umbrella clauses typically providing for the Parties to 'respect', 'observe' or 'abide by' all their obligations and commitments to the foreign investors.[6]

Even if it may seem that umbrella clauses are jurisdictional, they bring an additional substantive Bilateral Investment Treaty (BIT) obligation indeed. As it is a substantive treaty commitment, the contractual states have to adhere to the umbrella clause obligation.[7]

An umbrella clause is a provision in a BIT that provides the compliance of obligations of host state to the investor. These provisions are called "umbrella clauses" since they put contractual agreements under the treaty's protective umbrella.[8] In other words, umbrella clauses have been understood as the clause for the

2 Jonathan B. Potts, "Stabilizing the Role of Umbrella Clauses in Bilateral Investment Treaties: Intent, Reliance, and Internationalization", Virginia Journal of International Law, 51/4 (2011): 1030.

3 David Collins, An Introduction to International Investment Law (Cambridge: Cambridge University Press, 2016), 146.

4 Christoph Schreuer, "Investment Treaty Arbitration and Jurisdiction over Contract Claims-the Vivendi I Case Considered", in *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law,* ed. Todd Weiler, (London: Cameron May, 2005), 301.

5 Joachim Karl, "The Promotion and Protection of German Foreign Investment Abroad", *ICSID Review - Foreign Investment Law Journal,* 11/1 (1996): 23.

6 Gus van Harten, "The Public-Private Distinction in the International Arbitration of Individual Claims against the State", *International and Comparative Law Quarterly,* 56 (2007): 388.

7 Taida Begic Sarkinovic, "Umbrella Clauses and Their Policy Implications", *Hague Yearbook of International Law,* 24 (2011): 316.

8 Christoph Schreuer, "Travelling the BIT-Route-Of Waiting Periods, Umbrella Clauses and Forks in the Road", *The Journal of World Investment & Trade,* 5/2 (2004): 250.

compliance of contractual obligations by the host state having entered into the investment treaty with the investor's state.[9] In this respect, foreign investment protection is extended to any obligation made by the state in terms of the investment where there is an umbrella clause in the BIT.[10] That is to say, if there is an umbrella clause, a contractual breach gives rise to a violation of the international treaty, and thus it can be contended in international arbitration.[11] Nonetheless, interpretation of umbrella clauses is quite conflicting.[12]

After 1945, the question whether domestic law in the host state enabled adequate legal protection to justify the expenses of large scale projects was asked. Accordingly, umbrella clauses were considered as a bridge between domestic law and public international law to grant the investor more public law security.[13] There are various versions of umbrella clauses, differing from provision to provision in several BITs.[14] The British Model Treaty includes an umbrella clause in Article 2(2) "Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other contracting Party". The Mexico-Netherlands BIT[15] provides that "Each Contracting Party shall observe any other obligation in writing, it has assumed with regard to investments in its territory by nationals of the other Contracting Party. Disputes arising from such obligations shall be settled under the terms of the contracts underlying the obligations." The BIT between Germany and Pakistan of 1959 included an umbrella clause.

9 Katia Yannaca-Small, "What Abaout This Umbrella Clause", in *Arbitration Under International Investment Agreements,* ed. Katia Yannaca-Small, (Oxford: Oxford University Press, 2010), 479.

10 Schefer, International Investment Law, 503.

11 Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law**,** (Oxford: Oxford University Press, 2012), 168.

12 Raul Pereira De Souza Fleury, "Treaty-Protected Investment Agreements: Of Umbrella Clauses and Privity of Contract", *Willamette Journal of International Law and Dispute Resolution*, 23/2 (2016): 322.

13 Dolzer and Schreuer, Principles of International Investment Law, 168.

14 Schefer, International Investment Law, 504.

15 Agreement on Promotion, Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the United Mexican States, Art 3(4) (Oct 1, 1999).

The Parliament was informed by the Government the impact of an umbrella clause "The violation of such an obligation [of an investment agreement] accordingly will also amount to a violation of the international legal obligation contained in the present Treaty".[16]

The most controversial point regarding umbrella clauses is that under what circumstances the investor is to be under the treaty's protection.[17] Although the prevailing view[18] is that an umbrella clause elevates contractual breach to the level of violation of treaty, arbitral award in SGS v Pakistan[19] in 2003 changed the conventional consideration of the clause.

II. APPLICATION OF UMBRELLA CLAUSES

The importance of the application of the umbrella clauses is that investment arbitration tribunals could have jurisdiction over claims for breach of contract.[20] Linguistic differences among the umbrella clauses have caused various interpretations as to the extent and effect of the clauses.[21] Due to the variety of models for umbrella clauses, arbitration tribunals construe their scope and decide jurisdiction over claims on a case-by-case basis.[22] It is contentious whether umbrella

16 Dolzer and Schreuer, Principles of International Investment Law, 167.

17 Dolzer and Schreuer, Principles of International Investment Law, 166.

18 Rudolf Dolzer and Margrete Stevens, Bilateral Investment Treaties, (The Hague, Boston, London: Martinus Nijhoff Publishers, 1995), 81; F. A. Mann, "British Treaties for the Promotion and Protection of Investments", *British Yearbook of International Law,* 52/1 (1981); Christoph Schreuer, "Travelling the BIT-Route-Of Waiting Periods, Umbrella Clauses and Forks in the Road", *The Journal of World Investment & Trade,* 5/2 (2004): 251.

19 SGS v. Pakistan, ICSID Case No.ARB/01/13 (6 Aug 2003), https://www.italaw.com/cases/1009, 07.03.2023.

20 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" *George Mason Law Review*, 14 (2006): 139.

21 Nigel Blackaby, Constantine Partasides, Alan Redfern and Martin Hunter, Redfern and Hunter on International Arbitration, (Oxford: Oxford University Press, Sixth Edition, 2015), 488.

22 Mary E. Footer, "Umbrella Clauses and Widely Formulated Arbitration Clauses: Discerning the Limits of ICSID Jurisdiction", *The Law and Practice of International Courts and Tribunals*, 16 (2017): 97.

clauses transform contract breaches by host state into level of breach of international treaty law automatically. On the one hand, some arbitral tribunals have applied these provisions widely, having given full effect to umbrella clauses, on the other hand, in some cases they have been construed restrictively.[23]

A. Broad Approach to Umbrella Clauses

The wide understanding of the scope of umbrella clause has been based on *pacta sund servanda*.[24] A broad interpretation of the clause was reflected in *Noble Ventures v. Romania.*[25] In this case the tribunal construed Article II(2)(c) of the BIT between the United States and Romania, which was "[e]ach party shall observe any obligation it may have entered into with regard to investments". The tribunal pointed out that an umbrella clause is "usually seen as transforming domestic law obligations into obligations directly cognizable in international law."[26] The Tribunal noted that "[i]n normal circumstances *per se* a breach of a contract by the State does not give rise to direct international responsibility on the part of the State. This derives from the clear distinction between municipal law on the one hand and international law on the other, two separate legal systems (or orders) the second of which treats the rules contained in the first as facts, as is reflected in *inter alia* Article Three of the International Law Commission's Articles on State Responsibility adopted in 2001."[27]

In *SGS v Philippines*[28] the Tribunal also gave a broad effect to the umbrella clause, having remarked that in the presence of an umbrella

23 Schefer, International Investment Law, 504.

24 Omolade Adeyemi Oniyinde and Tosin Ezekiel Ayo, "The Protection of Energy Investments under Umbrella Clauses in Bilateral Investment Treaties: A Mith or a Reality?", *Journal of Law, Policy and Globalization,* 61 (2017): 165; also see Elvira R. Gadelshina, "Hermeneutic Reflections on the Specific Purpose of Umbrella Clauses", *The Journal of World Investment & Trade,* 14 (2013): 827.

25 Noble Ventures v. Romania, ICSID Case no. ARB/01/11 (12 Oct 2005), https://www.italaw.com/cases/747, 07.03.2023.

26 Noble Ventures v. Romania, para. 53.

27 Noble Ventures v. Romania, para. 53.

28 SGS v. Philippines, ICSID Case No. ARB/02/6 (29 Jan 2004), https://www.italaw.com/cases/1018, 07.03.2023.

clause in the BIT, a breach of an investment contract will give rise to a breach of the investment treaty. The Tribunal considered that where the claims of treaty breach derived from contractual disputes, the tribunal has jurisdiction. It is interesting to mark that the Tribunal held that "Article X(2) makes it a breach of the BIT for the host state to fail to observe binding commitments, including contractual commitments. ...But it does not convert the issue of the extent or content of such obligations into an issue of international law."[29]

Likewise, in *Eureko v Poland*[30], it was stated that contract breaches by host state could be violations of the BIT's umbrella clause, even if they did not breach the BIT's other standards. The Tribunal held that "the plain meaning - the 'ordinary meaning'- of a provision prescribing that a State 'shall observe any obligation it may have entered into' with regard to certain foreign investment is not obscure. The phrase, 'shall observe' is imperative and categorical. 'Any' obligations is capacious; it means not only obligations of a certain type, but 'any'- that is to say, all - obligations entered into with regard to investments of investors of the other Contracting Party. ...The context of Article 3.5 [the umbrella clause] is a Treaty whose object and purpose is 'the encouragement and reciprocal protection of investment', a treaty which contains specific provisions designed to accomplish that end, of which Article 3.5 is one. It is a cardinal rule of the interpretation of treaties that each and every operative clause of a treaty is to be interpreted as meaningful rather than meaningless".[31]

Some other cases[32] and scholars[33] have supported the broad approach to umbrella clauses. As regards these cases, full effect was

29 SGS v. Philippines, para. 128.

30 Eureko v. Poland, Partial Award, (19 Aug 2005), https://www.italaw.com/cases/412, 07.03.2023.

31 Eureko v. Poland, para. 246, 248.

32 See LG &E Energy Corp., LG&E Capital Corp. & LG&E Int'l Inc. v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability (3 Oct. 2006), https://www.italaw.com/cases/621, 07.03.2023; Siemens A.G. v. Argentina, ICSID Case No. ARB/02/8 (17 Jan. 2007), https://www.italaw.com/cases/1026, 07.03.2023; Plama Concortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24 (27 Aug. 2008), https://www.italaw.com/cases/857, 07.03.2023; Duke Energy v. Ecuador, ICSID Case No. ARB/04/19 (18 Aug. 2008), https://www.italaw.com/cases/356, 07.03.2023.

granted to umbrella clauses. In these tribunals, it was generally confirmed that in the existence of an umbrella clause, breach of commitments undertaken by the host state amounted to a violation of the treaty.

Although the purpose of the umbrella clauses is to provide the promotion of investment, addressing the observance of undertaking by the host state, the approach giving full effect to the clauses seems to be too broad. From this point of view, even purely contractual breaches by the host state might be subject to international law domain.

B. Restrictive Approach to Umbrella Clauses

Whilst a number of tribunals have construed the umbrella clauses broadly, in some other cases, several limitations have been imposed upon the application of the clauses.

In *SGS v Pakistan*[34], the Tribunal interpreted the umbrella clause of the BIT between Pakistan and Switzerland which stated that "[e]ither Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investment of the investors of the other Contracting Party". The Tribunal declined the investor's umbrella clause claim. The Tribunal brought out four arguments while reaching the decision. One of the arguments was that the conventional understanding would include the small types of obligation, and therefore give rise to a flood of lawsuits before international tribunals. The second argument presented by the Tribunal was that other guarantees under the treaties would be seen supererogatory if a breach of small obligation allowed an international tribunal. Thirdly, it was considered that the clause was not placed in the substantive guarantees. And eventually, it was stated

33 Stanimir A. Alexandrov, "Breaches of Contract and Breaches of Treaty: The Jurisdiction of Treaty-Based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v Pakistan and SGS v Philippines", *The Journal of World Investment & Trade,* 5 (2004) 572; Kathryn Ballintine, "How Far Do Bits Bite- A Comparison of SGS v. Pakistan and SGS v. Philippines: Interpreting Umbrella Clauses in Bilateral Investment Treaties", *Cambridge Student Law Review,* 2 (2006): 36; Gregorio Salatino, "Overview of Umbrella Clauses", *Business Law International,* 13/1 (2012): 58.

34 SGS v. Pakistan, ICSID Case No.ARB/01/13 (6 Aug 2003).

that forum selection provision under the investment contracts would not be binding for the investor.[35] It was held that the umbrella clause in the BIT "[d]id not purport to a state that breaches of contract alleged by an investor in relation to a contract it has concluded with State (widely considered to be a matter of municipal rather than international law) are automatically 'elevated' to the level of breaches of international treaty law."[36] The Tribunal also stated that the umbrella clause might cover contract claims where such an intention was clearly manifested in the BIT. Therefore, it is crucial for contractual states to indicate their intentions to include or exclude international claims obviously in the drafting of the umbrella clause.[37] The decision in the *SGS v Pakistan* was criticised severely in the *SGS v Philippines* for failing to construe the umbrella clause under its ordinary meaning.[38] The decision in *SGS v Pakistan* appeared to be policy based.[39]

While the Tribunal in *SGS v Philippines* applied the clause too broadly, in *SGS v Pakistan* the Tribunal ruled the umbrella clause extremely restrictively. The umbrella clause was left with little meaning. From this sort of limited approach, it is hard to see what role an umbrella clause has.

Some other tribunals[40] have advocated the approach argued in *SGS v Pakistan*. In 2006, in *El Paso v Argentina*[41] and in *Pan American*

35 Dolzer and Schreuer, Principles of International Investment Law, 172.

36 SGS v. Pakistan, para. 166.

37 Siqing Li, "Convergence of WTO Dispute Settlement and Investor-State Arbitration: A Closer Look at Umbrella Clauses", *Chicago Journal of International Law,* 19/1 (2018): 218.

38 SGS v Philippines, para. 125: "Not only are the reasons given by the Tribunal in SGS v. Pakistan unconvincing: the Tribunal failed to give any clear meaning to the 'umbrella clause'. … But Article 11, if it has any effect at all, confers jurisdiction on an international tribunal, and needs to do so with adequate certainty. Jurisdiction is not conferred by way of 'an implied affirmative commitment' or through the characterisation of circumstances as 'exceptional'."

39 Ballintine, "How Far Do Bits Bite", 36.

40 See Toto Construzioni Generali S.p.A. v. The Republic of Lebanon, ICSID Case No. ARB/07/12, Decision on Jurisdiction (11 Sept 2009), https://www.italaw.com/cases/1108, 07.03.2023; Salini Costruttori S.p.A. & Italstrade S.p.A. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/02/13, Decision on Jurisdiction (9 Nov 2004), https://www.italaw.com/cases/954, 07.03.2023.

v Argentina[42], Tribunals confirmed the restrictive understanding of umbrella clauses however introduced the difference between state's acts of sovereign and state's acts of merchant.[43] In *El Paso*, the significant question was connected with whether the umbrella clauses had the impact of converting all contractual obligations into international law undertakings and, accordingly, transforming breaches of contract into breaches of the BIT.[44] In *El Paso*, the Tribunal underlined the need of equilibrium between protection of foreign investment and state sovereignty. The Tribunal stated that "[t]he umbrella clause in Article II of the BIT ... will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the state or state-owned entity but will cover additional investment protections contractually agreed by the state as a sovereign-such as stabilization clause- inserted in an investment agreement."[45] Thus, *El Paso* supported the middle approach.[46] In *Pan American* the Tribunal considered that "[i]n the Tribunal's view, this umbrella clause does not extend its jurisdiction over any contract claims that the claimants might present as stemming solely from the breach of a contract between the investor and the Argentine State or an Argentine autonomous entity. Moreover, in the Tribunal's view, it is especially clear that the umbrella clause does not extend [its jurisdiction] to any contract claims when such claims do not rely on a violation of the standards of protection of the BIT, namely, national treatment, MFN clause, fair and equitable treatment, full protection and security, protection against arbitrary and discriminatory measures, protection against

41 El Paso Energy v. Argentina, ICSID Case No. ARB/03/15, Decision on Jurisdiction (27 April 2006), https://www.italaw.com/cases/382, 07.03.2023.

42 Pan American/BP v. Argentina, ICSID Case No. ARB/04/8, Decision on Preliminary Objections (27 July 2006), https://www.italaw.com/cases/172, 07.03.2023.

43 Dolzer and Schreuer, Principles of International Investment Law, 172, 173.

44 David Foster, "Umbrella Clauses: A Retreat from the Philippines", *International Arbitration Law Review*, 9 (2006): 100.

45 El Paso Energy v. Argentina, para. 81; see also Joy Mining Machinery Limited v. The Arab Republic of Egypt, ICSID Case No. ARB/03/11, Award on Jurisdiction, (6 August 2004), paras. 81–82, https://www.italaw.com/cases/590, 07.03.2023.

46 Mihir C. Naniwadekar, "The Scope and Effect of Umbrella Clauses: The Need for a Theory of Deference?", *Trade, Law and Development,* 2/1 (Spring, 2010): 179.

expropriation or nationalisation either directly or indirectly, unless some requirements are respected."[47] In this regard, the Tribunals pointed out that solely disputes based on state contract regarding acts of sovereign will be covered by investment arbitration. Hence, both decisions did not limit the scope of the umbrella clause as dramatically as *SGS v Pakistan*. However, they brought distinction between the state's activity as a merchant and as a sovereign. In scholarship[48] the argument that umbrella clauses merely cover breaches of contracts stemming from sovereign activities has been supported recently.

In *CMS Gas Transmission Co. v Argentina*[49], the Tribunal also remarked the distinction between the state activity as a merchant and as a sovereign, assessing the nature of the state's interference with the contract. The Tribunal noted that "[t]he tribunal believes the Respondent is correct in arguing that not all contract breaches result in breaches of the treaty. The standard of protection of the treaty will be engaged only when there is a specific breach of treaty right and obligations or a violation of contract rights protected under the treaty. Purely commercial aspects of a contract might not be protected by the treaty in some situations, but the protection is likely to be available when there is significant interference by governments or public agencies with the right of the investor."[50] Likewise, the Tribunal in *Sempra v Argentina* found that merely a breach in the act of a sovereign state power but not an ordinary commercial breach could violate the umbrella clause in the BIT between Argentina and US. The Tribunal held that the sweeping changes which host state had brought were in

47 Pan American/BP v. Argentina, para. 112.

48 See Francesco Costamagna, "Investor' Rights and State Regulatory Autonomy: The Role of the Legitimate Expectation Principle in the CMS v Argentina Case", *Transnational Dispute Management,* 3 (2006); Richard Happ, "Dispute Settlement under the Energy Charter Treaty", *German Year Book of International Law,* 45 (2002): 347; Richard Happ and Noah Rubins, "Awards and Decisions of ICSID (W. Bank) Tribunals in 2004", *German Year Book of International Law,* 47 (2004): 921; Thomas W. Wälde, "Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience", in *Arbitrating Foreign Investment Disputes,* ed. Norbert Horn, Stefan Kröll (Kluwer Law International, 2004).

49 CMS Gas Transmission Co. v. Argentina, ICSID Case No. ARB/01/8 (12 May 2005), https://www.italaw.com/cases/288, 07.03.2023.

50 CMS Gas Transmission Co. v. Argentina, para. 299.

action of the state's public power. Thus, these breaches of the obligations had led to a breach of the umbrella clause.[51]

The understanding that umbrella clauses cover solely governmental breaches has been found unconvincing and criticised in scholarship. One of the reason is that differentiating between governmental and purely commercial activity is practically difficult.[52] In addition, it has been claimed that the distinction disregards that to maintain efficient investor-state cooperation and contracting, host state obligations require to be protected not merely against breaches of governmental activity, but also against breaches of a commercial nature.[53]

It also must be mentioned that in the presence of a forum selection clause in the contract between the investor and the state, despite their broad understanding of umbrella clauses, various investment tribunals[54] have referred the disputes to the selected courts. On the other hand, in several cases[55], exclusive forum selection clauses have not precluded the dispute from international investment tribunal.[56]

III. ANALYSIS

In order to give an answer to the question whether umbrella clauses in BITs should be enforceable by arbitration tribunals, a logical path should be traced. In this regard, initially, it must be contemplated whether the umbrella clauses elevate breaches of the contract between

51 Sempra v. Argentina, ICSID Case No. ARB/02/16 (28 Sept 2007), https://www.italaw. com/cases/1002, 07.03.2023.

52 Judith Gill, "Contractual Claims and Bilateral Investment Treaties", *Journal of International Arbitration*, 21/5 (2004): 407.

53 Stephan W. Schill, "Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties", *Minnesota Journal of International Law,* 18 (2009): 39.

54 See SGS v. Philippines; Bosh Int'l Inc v. Ukraine, ICSID Case No. ARB/08/11 (25 Oct 2012), https://www.italaw.com/cases/1563, 07.03.2023.

55 See LG&E Energy Corp. v. Argentina; Eureko B.V. v. Poland.

56 Katherine Jonckheere, "Practical Implications from an Expansive Interpretation of Umbrella Clauses in International Investment Law", *South Carolina Journal of International Law & Business,* 11 (2015): 161.

the host state and the investor to the level of violation of the treaty. In other words, it should be examined whether the umbrella clauses convert the contractual breaches by the host state into the violation of the international law. Subsequently, this also brings the following question: Do umbrella clauses enable international protection against all types of breaches including those arising from purely commercial acts of the host state? That is to say, it should be argued whether in the existence of the umbrella clause in the BIT between the states, all types of breaches of commitments undertaken by the host state with respect to investment lead to a violation of international treaty or there should be distinction between the state's activities.

The interpretation of umbrella clauses by the tribunals demonstrates that understanding of the rule in a controversial position. What stands out from the various decisions is that the crucial issue is whether all sorts of breaches of contracts between the state and the investor would amount to a breach of the investment treaty in the presence of an umbrella clause.

From a traditional point of view, under international law a breach of private contract by a state does not result in international responsibility on that state. Accordingly, normally a foreign investor can only sue the host state before the domestic courts of the host state. However, foreign investors generally do not rely on domestic courts, particularly in developing countries which are usually under unstable legal and economic conditions. Foreign investors have doubts that domestic law can assure legal protection for their large-scaled investments. In this sense, umbrella clauses have been provided in BITs to guarantee to investors the compliance of commitments, and therefore, the continuity and the certainty of legal conduct.

Looking at the terminology of an umbrella clause, it generally states that each Contracting State shall undertake to observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party. Umbrella clauses are written in a way as general as possible and do not distinguish between state's obligations of a commercial or sovereign feature. Therefore, application and construal of umbrella clauses are pretty contentious. One of the

view of interpretation gives full effect to the umbrella clauses whereas the other view of interpretation brings limitations to the umbrella clauses. As explained above, from the wide approach of view, the main objective of umbrella clauses is to protect foreign investment, providing international remedies to foreign investors. From this perspective, if umbrella clauses did not allow international arbitration, what would main goal be? Conversely, restrictive view has alleged that broad interpretation could cause a flood of lawsuits when numerous contracts are under the extent of international law. In addition, some tribunals have supported this argument, claiming distinction between state acting as a commercial and as a sovereign. Both views have a close look, deep examination, strong and overwhelming arguments.

Host states are free to broaden the extent of treaty jurisdiction as much as they want. Acceptably, the preferable application is that such broadening is unequivocally obvious from the BIT.[57]

However, umbrella clauses are designed in a vague way and it is generally hard to find them in BITs. Therefore, they are quite sensitive. Tribunals should be meticulous and cautious while construing wide and ambiguous umbrella clauses. At this point, it is pivotal to find out the contracting states' real intention. General terminology is likely to demonstrate a standard of legal conduct rather than an acquiescence to international arbitration.

A State as a legal person has the ability to enter into private contracts as any private entity or citizen. Particularly considering such private contracts which host state enters into as an act of merchant, claiming even ordinary contract breaches before international investment arbitration through an umbrella clause could give rise to overprotection of foreign investors. Equilibrium of interests of foreign investors and host states ought to be maintained while interpreting the clause. Granting excessive power to foreign investors through the umbrella clauses seems to be beyond the intention of the host state. In this sense, the sensible and balanced solution could be to differentiate the state's activities as act of

[57] Velimir Zivkovic, "Contracts, Treaties and Umbrella Clauses: Some Jurisdictional Issues in International Arbitration", *Belgrade Law Review,* 3 (2012): 354.

merchant and act of sovereign as argued in *El Paso* case. Thus, if the host state is exercising a governmental action which solely belongs to a government, a breach of such a contract can amount to a treaty violation. Accordingly, it is natural to sue the host state in international tribunals. Notwithstanding an umbrella clause, this should not be the case when the host state exercises as a merchant. Where the host state merely enters into a simple, ordinary commercial contract with the foreign investor, breach of such contract by host state should not lead to an international law violation. Nevertheless, it could be argued that these claims may be pursued before commercial arbitration in the existence of arbitration clause with the parties' consent to arbitration.

Umbrella clauses are generally ambiguous, short and hidden, and thus, may simply be missed by the host states. They provide power to foreign investors sometimes more than that the contractual states may have intended.[58] Regarding inconsistent arbitral decisions due to its controversial nature, it could be risky for a state to include an umbrella clause in BITs. Particularly developing countries should be careful and cautious at this point, given that some foreign investors such as international corporations are likely to be more prosperous than some developing countries with the profound influence of globalization. In this regard, if they do not want to face with international responsibility, in particular for their ordinary private contract breaches, host states should not include an umbrella clause. On the other hand, it is not a surprise that states may wish to provide international protection to foreign investors in order to promote investments and to sustain investor-state cooperation. If a state wishes to extend the scope of treaty jurisdiction, such extending should be clear and uncontroversial in the BIT. Typically, states do that through the umbrella clauses. Where the wording of the clauses is ambiguous, general and wide, tribunals usually tend to give the umbrella clauses full effect. Hence, so as to limit the scope of international protection provided through the clauses, states should use more qualified, explicit and comprehensive language in their BITs.

58 Collins, An Introduction, 146.

CONCLUSION

In conclusion, giving an answer to the question whether umbrella clauses in international Investment Agreements should be enforceable by arbitration tribunals is not straightforward. Both broad and restrictive views have strong arguments. Both views have proponents from scholars and international tribunals.

Apparently, host states are enabled to broaden the extent of treaty jurisdiction by means of umbrella clauses to encourage foreign investments. It is also comprehensible that foreign investors would like to pursue their claims before international tribunals rather than domestic courts of host states.

Certain types of legal undertakings such as purely contractual obligations promised by the host state as an act of merchant seem to be unsuitable to be pursued before international investment tribunals, particularly taking their private law nature into consideration, notwithstanding *pacta sund servanda*. Nonetheless, it could be arguably accepted that these contract breaches might be brought before commercial arbitration if there was an arbitration clause in the contract by the consent of the parties. On the other hand, it is natural that breach of contracts arising from the host state's governmental activities could be enforceable by investment arbitration tribunals by means of umbrella clauses. Although this argument seems to be the most reasonable and appropriate answer to the question regarding the enforceability of the umbrella clauses, one should note that it is not an easy task to discern commercial and sovereign acts of government.

Given that umbrella clauses are usually vague and short, and that conflicting arbitral decisions have been held, host states, particularly developing countries should be meticulous while drafting clauses when entering into BITs. Negotiators should circumscribe the equivocal issues, namely scope and the effect of the umbrella clause diligently, evaluating potential disputes in order that arbitration tribunals can implement the clauses accurately and in accordance with the parties' real intentions.

As is delineated in the *BIVAC v Venezuela* that "there is no *jurisprudence constante* on the effect of [such] clauses, that the subject is one on which legal opinion is divided, that the relationship between commercial and sovereign acts of government is not free from difficulty, and that each particular clause falls to be interpreted and applied according to its precise wording and the context in which it is included in a BIT."[59]

According to the United Nations Conference on Trade and Development (UNCTAD)[60], recent international investment agreements tend to omit the umbrella clause whereas old treaties generally include it. This approach could be seen as the beginning of the end for the umbrella clause. Nevertheless, controversial issues derived from old-generation treaties seem to be continued.[61]

YAZAR BEYANI	
Mali Des-tek/Teşekkür Beyanı:	Bulunmamaktadır.
Yazarların Katkıları	Eserin tamamı yazar tarafından kaleme alınmış-tır.
Çıkar Çatışma-sı/Ortak Çıkar Beyanı	Yazar tarafından herhangi bir çıkar çatışması veya ortak çıkar beyan edilmemiştir.
Etik Kurul Onayı:	Gerekmemektedir.

59 Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. The Republic of Paraguay**,** ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, (29 May 2009), para. 141, https://www.italaw.com/cases/179, 07.03.2023.

60 UNCTAD, "IIA Issues Note, International Investment Agreements, Review of ISDS Decisions in 2019: Selected IIA Reform Issues", January 2021, https://unctad.org/system/files/official-document/diaepcbinf2021d1_en.pdf (07.03.2023).

61 Samantha Rowe and Svetlana Portman, "Current Trends in 'Umbrella Clause' Claims Arising From Breaches of Contractual Obligations", *International Bar Association*, (June 2021), https://www.ibanet.org/current-trends-umbrella-clause-claims (22.02.2022).

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