4. THE UMBRELLA CLAUSE

A. General Considerations

A particularly important provision in determining the impact of international investment treaties on state contracts is the so-called “umbrella clause”. In simple terms the clause is susceptible of turning breaches of contractual commitments under domestic law into violations of international law. As such, the effect of the clause may have a revolutionary impact upon the resolution of contractual matters before international arbitral tribunals.

The clause goes by many names; whether “pacta sunt servanda clause”, “sanctity of contract clause”, “respect clause”, “observation of undertaking clause”, “mirror clause”, or “umbrella clause”, the effect that it is contended to have remains the same. By the establishment of the host State’s international obligation to “observe any obligation it has assumed” or to “constantly guarantee the observance of the commitments it has entered into”, a breach of contract may entail international liability. Some authors even assert that the whole content of an

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1 For one of the early descriptions to this effect, see F. A. Mann, British Treaties for the Promotion and Protection of Investments, BYIL 52 (1981), 241, 246. The author stated that the clause protects the investor against any interference with his contractual rights, whether it results from a mere breach of contract or legislative or administrative act, and independently of the question of whether or not such interference amounts to expropriation. The variation of the terms of the contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for instance, by non-payment, the dissolution of the local company with which the investor may have contracted and the transfer of its assets (with or without liabilities)-these and similar acts the treaties render wrongful.

2 See OECD, Interpretation of the Umbrella Clause in Investment Agreements, Working Papers on International Investment, No. 2006/3, October 2006, available at: www.oecd.org (last visited: 12 April 2010), 3. In French, the clause has been termed “traité de couverture”. Cf. P. Weil, Problèmes relatifs aux contrats passés entre un état et un particulier, RdC 128 (1969-III), 95, 130 et seq. In German, the most commonly used term is the notion “Abschirmungsklausel”.

3 For a typical umbrella clause, see, e.g., article 8(2) of the German Model BIT 1992: “Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party.”
eventual investment contract between a host State and an investor is elevated to the international realm in some way.\textsuperscript{4} In any event, the unarguably fascinating impact of the clause is not at all certain.

Umbrella clauses are not of very recent appearance. In fact, the clause already emerged before the conclusion of the first BIT and became an inherent part of BITs from the very beginning of investment treaty law and onward. Nonetheless, the clause did not find any application for decades.\textsuperscript{5} In 2003, however, the emergence of two cases, the SGS cases, abruptly altered this situation.\textsuperscript{6} The two disputes arose out of service contracts which SGS had concluded with Pakistan and the Philippines respectively. Although the wordings of the umbrella clauses in both applicable BITs did not differ considerably,\textsuperscript{7} the two tribunals issued contradictory judgements on the issue of the effect of the clause. Henceforth, several controversies concerning the effect and the scope of the umbrella clause became vivid.

For the present purpose, only the clause’s impact upon state contracts is of interest. The questions which arise in this regard are among others whether and if so, how umbrella clauses extend the investment treaty protection to state contracts. Moreover, the question what kind of interferences a contractual relationship between foreign investor

\textsuperscript{4} See, e.g., V. Zolia, Effect and Purpose of “Umbrella Clauses” in Bilateral Investment Treaties: Unresolved Issues, TDM 2 (2005), No. 5, 1, 42: “[I]f adjudicating over commitments under the original system of law where they were taken, it would make it impossible to create a uniform international standard for the protection of investors”.

\textsuperscript{5} Effectively, this holds true for the whole range of BIT provisions since virtually no use for these agreements was made before the end of the 1980s.

\textsuperscript{6} SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August 2003, ICSID Rev.-FILJ 18 (2003), 301; ILM 42 (2003), 1290 (hereinafter, SGS v. Pakistan); SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004, 8 ICSID Rep. 518 (hereinafter, SGS v. Philippines). In both cases, SGS had concluded contracts directly with the respective governments concerning the provision of “pre-shipment” inspection services with respect to goods to be exported from foreign countries. Whereas in SGS v. Pakistan, the claim was lodged due to several alleged breaches of the BIT such as the wrongful repudiation of the contract and failures to protect SGS’s investment, in SGS v. Philippines, the dispute arose merely out of a refusal to pay open invoices.

\textsuperscript{7} Article 11 of the Switzerland—Pakistan BIT reads as follows: “Either 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.” Under the heading “Other Commitments”, article X(2) of the Switzerland—Philippines BIT stated the following: “Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party.”