Umbrella Clauses and Investment Contracts under Chinese BITs: Are the Latter Covered by the Former?

Wenhua SHAN*

1. INTRODUCTION

Recent arbitration practice shows that the umbrella clause has become one of the most challenging provisions in bilateral investment treaties (BITs). The clause takes its name from its main objective, namely bringing obligations of a host state to foreign investors under the protective umbrella of an applicable BIT or a multilateral investment treaty.1 The umbrella clause can have far-reaching implications, the exact boundary of which is yet to be delimited. Recent conflicting decisions by different arbitration tribunals on this matter suggest that the extent to which such clauses might “elevate” contractual obligations between a host state and a foreign investor to the level of treaty obligations is far from settled.

Umbrella clauses arguably cover both contractual and non-contractual obligations.2 However, it is undisputed that this clause is most closely associated with investment contracts, namely state contracts or “concession agreements.” Guaranteeing rights under state contracts is arguably the primary purpose of the clause.3 Hence it is better to address the two issues together.

---

1 The Energy Charter Treaty for example has an umbrella clause in the last sentence of Article 10(1).
2 Umbrella clauses can potentially extend protection to non-contractual obligations undertaken by host states towards foreign investors in the form of, for instance, laws, regulations or licenses. For example, a UNCTAD research notes that ‘the language of the provision is so broad that it could be interpreted to cover all kinds of obligations, explicit or implied, contractual or non-contractual, undertaken with respect to investment generally. A provision of this kind might possibly alter the legal regime and make the agreement subject to the rules of international law’.
3 It has been noted that the concept of umbrella clause was first conceived by Sir Elihu Lauterpacht when he was advising the Anglo-Iranian Oil Company in early 1950s. And the purposes of such a device were to ensure that the host state observe its commitments towards foreign investors under a particular investment contract. AC Sinclair, ‘The Origins of the Umbrella Clause in the International Law of Investment Protection’ 20 Arbitration International (2004, No. 4), 414-418. See also T Walde, ‘The “Umbrella Clause” in Investment Arbitration: A Comment on Original Intentions and Recent Cases’ The Journal of World Investment and Trade (Vol. 6, April 2005 No. 2), 200-209.
China has now entered into more than 120 BITs and at least 50 of them have an umbrella clause. Meanwhile, there has been extensive practice of investment contract in China, particularly in the context of joint venture, joint exploitation (of petroleum resources) and build-operate-transfer operations. Although luckily so far there has been no case against China in international forum testing the application of such BIT provisions, it is important to analyse them now given that there have already been such cases in domestic courts and tribunals and that there is huge potential of such cases in international forums in the wake of recent open access to international arbitration granted in recent BITs.

This article therefore attempts to examine the umbrella clauses in Chinese BITs and investment contracts in China by mainly referring to jurisprudence in arbitration and court cases. It will first examine the umbrella clauses in Chinese BITs and discuss their legal implications by referring to jurisprudence of recent arbitration cases. It then moves on to analyse the main issues relating to investment contracts in China, including their nature, governing law, stabilisation clause, governmental guarantees and dispute settlement. It concludes that whilst joint venture contracts normally are not states contracts, joint exploitation and BOT contracts are likely to be considered as state contract subject to the protection of umbrella clause under applicable investment treaties.

2. UMBRELLA CLAUSES IN CHINESE BITs

Among China's 120 strong BITs, only less than half of them (50) have a standard umbrella clause or observation of obligations provision. This percentage is similar to the result of a survey on general BITs, which revealed that only about 40% of the BITs had such a clause. The following section examines these clauses in Chinese BITs, including the standard and non-standard (broader or narrower) formulations, and its interaction with other BIT provisions such as "preservation of rights" clauses and the most-favoured-nation clause (the MFN Clause).

---

4 See eg Changchun Huijin and Fuzhou Xingyuan cases, the details of which can be found in Wenhua Shan, The Legal Framework of EU-China Investment Relations: A Critical Appraisal, Oxford Hart Publishing 2005, pp. 227-229.

5 Since 1998, China has started to sign BITs with open access to international arbitration including ICSID arbitration. Under such BITs, not only previously allowed disputes concerning amount of compensation can be submitted to ICSID arbitration, all other investment dispute can also be submitted. For details see Wenhua Shan and Norah Gallagher, Chinese Investment Treaties: Policy and Practice, Oxford University Press 2009, paras. 177-180 and 8.49-8.55.

6 A few other BITs contain a "preservation of rights" clause, which has similar effect to an umbrella clause. See section 1.3.1 below.