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Inconsistency Crisis and Reformative Proposals of Investor-state Arbitration System- Umbrella Clauses Considered

Abdallah Elsayed
abdalla_elsayed@aucegypt.edu

The American University in Cairo

School of Global Affairs and Public Policy

INCONSISTENCY CRISIS AND REFORMATIVE PROPOSALS OF INVESTOR-STATE ARBITRATION SYSTEM- UMBRELLA CLAUSES CONSIDERED

A Thesis Submitted by

Abdallah Mahmoud Elsayed

To the Department of Law

Spring 2022

in partial fulfillment of the requirements for the LL.M. Degree in International and Comparative Law

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LLM Degree in International and Comparative Law
has been approved by the Committee composed of

Thomas Skouteris (Supervisor)
Associate Professor and Chair
_____
Law Department
The American University in Cairo
Date _____

Hani Sayed (First Reader)
Associate Professor
_____
Law Department
The American University in Cairo
Date _____

Jason Beckett (Second Reader)
Assistant Professor
_____
Law Department
The American University in Cairo
Date _____

Graduate Program Director	**Date**	**School Dean**	**Date**
_____	_____	_____	_____
Thomas Skouteris		Ambassador Dean Fahmy	

DEDICATION

I proudly dedicate this paper to my father, may he rest in peace, to whom I owe every virtue I live by and every blessing in my life. To my mother, I profess that nothing can make it up for your sacrifice for me and my sisters. I also dedicate this work to my beloved daughter, Ellen, who I hope to be proud and have an inspiring and a prosperous life.

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Life will always amaze you with new experiences. Revealing one's true essence is a double-edged blessing. This may be the main reason for me to pick this research topic. To dig in order to attain the true and actual intent of a person needs a lot of experience. However, it is like running in a maze that will never reach a satisfying end.

Joining the AUC is a life-changing experience. I sincerely owe that mind storm that it avails for me. There is no such a limit for anything or anyone. There is always more, for anyone to start over, and to be the best version of themselves. I'm grateful that my first tutors were Ms. Diana Van Bogeart and Dr. Thomas Skouteris. I'm truly grateful for Ms. Dianna Van Bogeart who was the first one to introduce me to that brand new experience. Her teaching process was extraordinary and had a great impact on my experience. I'm sincerely grateful for Dr. Skouteris who had a great effect in shaping my critical thinking and from whom I have learnt that the authenticity of a thought is all what matters. I'm also thankful for Dr. Hani Sayed, Dr. Hedayat Hekal and Dr. Dalia Hussein who have a great effect with their comments and lectures in sharpening that critical experience.

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ABSTRACT

The main purpose of investment treaties is to provide guarantees and protections for the investors in order to maintain the flow of foreign direct investment. As a consequence, when disputed, an adjudicator confronts a dilemma of figuring out the actual intention that the parties consented to. As for umbrella clauses are concerned, an interpreter falls into a loop to attain whether the parties consented to prioritize investor's interest and elevate any contractual breach to the level of a treaty breach, or to consider the state's regulatory power. The root could be traced to the interpretation process itself. Human conduct differs from one another even in response to similar incidents. This is attributed to the fact that it is affected by many factors, such as previous experience, culture and traditions that may differ from one another. Likewise, interpretation, a human conduct as such, cannot be predicted even to similar texts. Moreover, even interpreters use the same tools and principles, they may reach contradictory outcomes. This paper argues that the interpretation process will always have its way to conclude different outcomes. However, instituting a centralized court for foreign investment disputes with an appellate body assigned with review of legal merits, composed of tenured, state-appointed judges, alongside with inserting public law concepts in investment adjudication can mitigate the political symptoms of the system and its inconsistent awards.

KEY WORDS: umbrella clauses, interpretation, investor-state arbitration, permanent court, public law, proportionality, EU model.

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I. Introduction.

A Chinese proverb reads, “there are three truths: my truth, your truth, and the truth.” Personally, I cannot agree more with that quotation. Revealing the covert intentions of a human being is, and will always be, like chasing a mirage, you think you see the truth and are approaching it, but you do not reach it. The ultimate truth is always debatable; each party to a humanitarian relationship whatsoever believes that the truth is by their side. Detecting the mutual intention of the parties reflects an intervention into a grey area that encompasses a lot of possibilities of equal probability.

The purpose of the interpretation process is to figure out the subject consent of the parties in the light of the available objective indications. Hence, Interpretation, a human conduct as such, could be affected by personal experiences, culture and traditions. Hence, its outcome cannot be predicted and no outcome whatsoever can be conclusively alleged to be the ultimate one. Despite the fact that arbitrators are guided by the same *objective* indicators and apply the same general principles of law, they may attain totally contradictory outcomes regarding what states have consented to.

Umbrella clauses represent a part of the bigger picture that interpretation causes. An adjudicator while interpreting such a clause may fall into a loop for detecting the prevailing and the actual mutual intention in the light of the contradicting interest of both parties. It is undeniable that the first inclusion of umbrella clauses was to guarantee protection for investors in order to maintain foreign direct investment flow which is an integral incentive for states to conclude such treaties. However, would that intent goes to the extent that a state may accept that such a clause imposes restrictions on its regulatory power.

Part II of this paper traces the historical development of umbrella clauses starting from its very inclusion and its main aspired purpose. Then, it reflects the inconsistency in tribunals’ jurisprudence regarding interpreting umbrella clauses in investment treaties. It illustrates the reasoning of each approach and their distinct conclusions and the diverse methodologies even within the ones that adopted the same approach. Part III illustrates that the inconsistency in arbitral awards regarding umbrella clauses is a pragmatic façade of the interpretation conundrum. It dictates the path drawn by the Vienna convention and concludes that it proposes such a broad and vague criteria that still governed by *subjective* ideologies of interpreters asserting its

political nature. Part IV proposes solutions for attaining consistency in investment arbitration. It explores the advantages and disadvantages of each proposal and concludes that neither proposed attempt can provide an absolute solution for the consistency or the impartiality of the system. However, a project that encompasses a centralized permanent court composed of tenured state-appointed judges who follow public law concepts in interpreting investment treaties can mitigate the inconsistency of the system. The new EU permanent investment court provides a great gesture of an impartial arbitration system that should be generalized.

II. Umbrella clauses.

A. The very emergence and purpose of umbrella clauses:

Foreign investments are often made through contracts between an investor and an entity or institution at the host state[1] in implementation of a bilateral investment treaty (BIT) concluded between the home state of the investor and the host state. Some BITs may contain a clause establishing a reciprocal obligation owed by the contracting states that requires them respect and observe the obligations they have entered into with investors of the other contracting state. These clauses may be inferred in many titles such as umbrella clauses, mirror effect, elevator, parallel effect, and respect clause.[2] Figuring out its main purpose requires tracing the very emergence and purpose of its first inclusion and the gradual evolvement the happened to its interpretation.

The origin of the notion of umbrella clauses as such could be traced back to the advice provided by Mr. Elihu Lauterpacht in 1953-1954 to the Anglo-Iranian Oil Company in connection with the settlement of the Iranian oil nationalization dispute.[3] The dilemma surrounding this case rose after the assassination of the Iranian Prime Minister and the appointment of this successor who called for nationalization. In 1951 the Iranian Oil Nationalization Law came into force, according to which all oil operations in Iran were to be carried out by the Iranian government.[4] After further negotiations for a settlement, Lauterpacht's advice was to incorporate international law as the proper applicable law in any settlement agreement. The purpose for such advice was to dispose of the jurisdiction of domestic courts and to establish an inter-state obligation to resort to international arbitration seeking for much more protection. The main purpose of such an agreement was to consider any breach of the contract or the settlement shall be *ipso facto* deemed to be a breach of the treaty between Iran and

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[1] 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*, 5 JWIT, 555, 555 (2004).

[2] Yannaca-Small, K, *Interpretation of The Umbrella Clause in Investment Agreements*, OECD Working Papers on International Investment, 3 (2006).

[3] Anthony C. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 Arbitration International 411, 412, (2004).

[4] *See* A.W. Ford, *The Anglo-Iranian Oil Dispute of 1951-1952* (University of California Press, Berkeley,
1954); L.P. Elwell-Sutton, *Persian Oil: A Study in Power Politics* (Lawrence & Wishart, London, 1955); J.H. Bamberg, *The History of the British Petroleum Company*, vol. 2, *The Anglo-Iranian Years, 1928-1954* (Cambridge University Press, Cambridge, 1994), p. 488; M.A. Heiss, *Empire and Nationhood: The United States, Great Britain, and Iranian Oil, 1950-1954* (Columbia University Press, New York, 1997.

the United Kingdom.[5] In other words, Lauterpacht intended to exclude any possible dispute regarding the settlement agreement form the application of the Iranian Law and hence being subject to a unilateral change by the Iranian government. For the same purpose, this concept was again proposed in 1956-57 in Lauterpacht's advice to a group of oil companies contemplating a trunk pipeline from Iraq in the Persian Gulf through Syria and Turkey to the Eastern Mediterranean.

The "umbrella clause" as a distinct investment protection clause was first included in the 1956-57Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries (the Abs draft).[6] It provided that:

> "In so far as better treatment is promised to non-nationals than to nationals either under intergovernmental or other agreements or by administrative decrees of one of the High contracting Parties, including most-Favored nation clauses, such promises shall prevail."

This clause reappeared in a much more explicit draft in the BIT between Germany and Pakistan in 1959 (Article 7) providing that "(e)ach party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other party."[7]

In conclusion, the very and main purpose of incorporating such a clause was to guarantee a higher level of protection for foreign investors and to maintain a resort out of the national jurisdiction assuming that it will avail more protection. However, recent case law showed inconsistency in arbitral awards due to different perspectives concerning the actual intent of the parties to an umbrella clause.

B. Inconsistent arbitral awards.

It is undeniable that the first inclusion of what so called umbrella clauses was aimed for the benefit of providing more protections and guarantees for foreign investors. The main purpose of these clauses was to avoid possible application of national laws and providing a resort to international arbitration seeking for more protection against any unilateral acts of national governments. However, further cases showed different ideologies of host states regarding their actual intuitions while concluding BITs. Debates have been raised by state parties to BITs concerning their actual consent to elevate contractual obligations to the level of treaty ones. The

[5] E. Lauterpacht, *Anglo-Iranian Oil Company Ltd Persian Settlement* - Opinion' dated 20 January 1954, 4.
[6] Yannaca-Small, K, *supra note* 2, 4.
[7] *Id*, 4.

critical effect lies in that in case it is considered a treaty breach, the treaty arbitration forum can consequently claim jurisdiction of which the national judiciary would be deprived over any dispute between the investor and the host state. That was the traditional understanding of the effect of these clauses within the literature and tribunals' jurisprudence until the *SGS v. The Islamic Republic of Pakistan* tribunal rendered its dissenting award in 2003. A few months later, another tribunal –*SGS v. the Republic of Philippines*- rendered a different interpretation of a similar umbrella clause assuring the traditional expansionary approach, creating a massive literature debate in this realm.

1. The narrower approach.

The *SGS v. Pakistan* award was the first to render such a restrictive interpretation for an umbrella clause. SGS was a Swiss company entered into an agreement with the Pakistani government for the provision of pre-shipment inspection services for goods to be exported to Pakistan from certain countries (PSI agreement).[8] It happened that the Pakistani government unilaterally terminated the concerned contract. After going through many litigation avenues, SGS filed a request for arbitration before the ICSID for violating the Switzerland-Pakistan BIT. Amongst the pleadings of SGS and for the purposes of this research, SGS claimed the breach of the umbrella clause included in Article (11)[9] of the concerned BIT requiring the Pakistani government to observe its contractual obligations.

The tribunal started dealing with that question by assuring that it followed the accepted norms of customary international law on treaty interpretation in terms of the object and purpose of the treaty. It stated that "[a] treaty interpreter must of course seek to give effect to the object and purpose projected by that Article and to the BIT as a whole (emphasis added)."[10]

Then the tribunal set forth textual and practical arguments for its conclusion. It stated that the commitments of which the observance shall be guaranteed by the contracting parties are not limited to contractual commitments. Therefore, they are susceptible to "*indefinite expansion*" to statutory, administrative or contractual commitments. Moreover, these commitments may be of the state itself or any other

[8] *See* https://iisd.org/itn/2018/10/18/sgs-v-pakistan/.
[9] Art. (11) provides that, "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."
[10] *SGS v. Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003, para 165.

entity whose conduct could be attributed to the state. Hence, the tribunal concludes that in the light of that broad indefinite text, it cannot be assumed that it was intended to elevate every breach in relation to the contract to the level of breaches of international treaty law:

> The 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 (widely considered to be a matter of municipal rather than international law) are automatically "elevated" to the level of breaches of international treaty law.[11]

Moreover, the tribunal assured that accepting the claimant's argument for that *sweeping* impact of such clause requires clear evidence which the claimant fails to provide:

> [c]onsidering further that the legal consequences … are so *far-reaching* in scope, and so automatic and unqualified and *sweeping* in their operation, so burdensome in their potential impact upon a Contracting Party, we believe that *clear and convincing evidence* must be adduced by the Claimant… that such was indeed the shared intent of the Contracting Parties to the Swiss-Pakistan Investment Protection Treaty in incorporating Article 11 in the BIT. We do not find such evidence in the text itself of Article 11. We have not been pointed to any other evidence of the putative common intent of the Contracting Parties by the Claimant (emphasis added).[12]

As for the practical implications, the tribunal proposed four arguments for not adopting such an expansive interpretation. First, that the far-reaching approach would result in an unlimited flow of lawsuits as any alleged violation of the unlimited state contracts and municipal legal regulations would be deemed as a breach of the BIT. Second, it would make other treaty guarantees superfluous, since any simple breach of contract would suffice to constitute a treaty violation. Third, the tribunal showed

[11] *Id*, para 166.
[12] *Id*, para 167.

concern about the inequitable consequences of such a broad interpretation. It claimed that it would override any contractual forum-selection clause for the benefit of the investor who would be free to resort to any dispute settlement mechanism either according to the contract or the BIT. On the contrary, the contracting state would be in a worse situation as it would be deprived of "any mutually agreed procedure of dispute settlement, other than the BIT-specified arbitration" unless the investor accepted it.[13] Forth, the tribunal paid attention to the location of the article stipulating the concerned clause. It concluded that the non-inclusion of that article within the substantive "first-order" standard obligations undertaken by state parties to the BIT reveals that they did not intent to incorporate it with any substantive obligation.[14]

Some tribunals have ended up to the same conclusion, but through different methodologies. The *Joy Mining v. Egypt* tribunal admitted the distinction between a contract-based claim and a treaty-based one and held that a purely contractual claim would have difficulty in meeting jurisdictional-test requirement for a treaty-based arbitral forum.[15] It followed the *Vivendi annulment committee* decision when held that "[a] treaty cause of action is not the same as a contractual cause of action; it requires a clear showing of conduct which is in the circumstances contrary to the relevant treaty standard."[16]

Thereof, the tribunal held that umbrella clauses are not meant to *unilaterally* transform every contractual breach to a treaty one unless that breach constitutes a breach of other treaty-based guarantees on its own. Then, it concluded that it lacks jurisdiction over the case because the fundamental basis of the claim is contractual which cannot be treated as a treaty breach since the incorporated umbrella clause has no such effect:

> it could not be held that an umbrella clause inserted in the Treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of the Treaty rights and obligations or a violation of contract rights of such a

[13] *Id*, para 168.
[14] *Id*, para 170.
[15] *Joy Mining Mach. Ltd. v. Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, para. 75 (2004).
[16] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on application for annulment, para. 113 (2002).

> magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect.[17]

To the same end, the tribunal in *El Paso v. Argentina* exposed its methodology that should end up in an interpretation that achieves justice between the protection of investment without jeopardizing state's sovereignty when stated that "a balanced interpretation is needed, taking into account both State sovereignty and the State's responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow."[18] It explained that such a far-reaching interpretation would render the whole treaty useless since it would render any breach of any legal obligation of the state, whatever its source or the degree of seriousness, as a breach of the treaty itself. As a result, there will be no need for other high substantive protection standards in the treaty.[19]

For achieving such balance, the tribunal proposed a very sensitive argument by stating that a distinction has to be made between a state as a merchant and as a sovereign.[20] It confirmed that the conduct of the state as a sovereign is the sole type from which investors have to be protected through resort to international arbitration, and this is the case where umbrella clauses may have full effect[21]. It defined this kind of contracts as those in which the state appears as a sovereign.[22] It is worthy to notice that this definition, to a large extent, resembles the definition of "*contrats administratifs*" theory. Hence, breaches of ordinary commercial contracts entered into by the state or a state owned entity would not amount to a breach of the treaty.

The tribunal asserted the backlash of such a broad interpretation of such clauses as disrupting the threshold between national and international legal orders.[23] Moreover, it ironically asked how private investors are supposed to use umbrella clauses appropriately if ICSID tribunals used to grant them unexpected remedies. It is,

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[17] *Joy Mining Mach. Ltd. v. Egypt*, *supra note* 9, para. 81.
[18] *El Paso v. Argentina*, ICSID Case No. ARB/03/IS, Decision on Jurisdiction, para. 70, (2006).
[19] *Id*, para. 76.
[20] *Id*, para 79.
[21] *Id*, para. 86.
[22] *Id*, para 80.
[23] *Id*, para. 82.

then, the responsibility of the tribunals to impose such appropriate restraints in order to attain justice between both interests.[24]

2. The expansionary approach.

Shortly after the *SGS v. Pakistan* award, an *ad hoc* tribunal rendered a contrary award in *SGS v. Philippines*, a case based on similar factual incidents, to the end that gives effect to the umbrella clause. In 1991, the Philippines entered a contract (CISS agreement) with SGS according to which the latter would provide pre-shipment inspection services of the Philippines' imports in the country of supply, including verification of the imports' quality, quantity, and price.[25] Because of the Philippine's non-payment of invoices, SGS filed a request for arbitration before ICSID claiming the tribunal's jurisdiction and Philippine's responsibility on the basis of, amongst others, the umbrella clause included in Art X (2)[26] of the Swiss- Philippines BIT.

The tribunal at first examined the textuality of the clause by asserting that it is phrased in an obligatory mandate using the term "shall" like other *substantive* standard obligation provisions of the BIT. The tribunal, then, deduced that the term "any obligation" is broad so much so that it encompasses obligations arising under national law including those arising from the contract.[27] It held that this phrase was much clearer than that of the Swiss-Pakistan BIT which reads "the commitments it has entered into with respect to the investments."[28]

Moreover, the tribunal held that any uncertainty in the language of an investment treaty should be interpreted in a way that effects the object and purpose of the BIT. Thereof, "It is legitimate to resolve uncertainties in its interpretation so as to favor the protection of covered investments."[29] Additionally, if the parties intended to limit its scope to obligations under international law, "such a limitation could readily have been expressed."[30] Thereof, this encompasses all commitments made by the host state towards investments and are considered binding even under municipal law.[31]

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[24] *Id*.
[25] Matthew Wendlandt, *SGS v. Philippines and the Role of ICSID Tribunals in Investor-State Contract Disputes*, 43 TEX. INT'l L. J. 523, 544 (2008).
[26] It reads, "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."
[27] *SGS v Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, para. 115 (2004).
[28] *Id*, para. 119.
[29] *Id*, para. 116.
[30] *Id*, para. 118.
[31] *Id*, para. 117.

The tribunal, then, refuted the reasons given by the *SGS v. Pakistan* tribunal. It held, in response to the argument that a broad interpretation is *susceptible of indefinite expansion*, that Art X (2) is not applicable to all legal obligations of general nature. Yet, it applies to those that have been assumed by the host state vis-à-vis the specific investment. Hence, it does not elevate to the international level all the municipal legislative or administrative or other unilateral measures that could be binding under the national legal system of the host state.[32] It added that an umbrella clause is not addressed to the *scope or the content* of these commitments, but to ascertain their performance according to their applicable law. So, it does not change the proper law from the municipal law of the contract to international law.[33]

Secondly, as for the principle relied on by the *SGS v. Pakistan* tribunal that "a violation of a contract entered into by a State with an investor of another State, is not, by itself, a violation of international law." It stated that the concerned BIT at the *Vivendi* case, form which that principle was cited, did not conclude a similar umbrella clause. It stated that that effect is a matter of interpretation rather than to be determined by any presumption, and an effective interpretation requires that effect. it added that even in the absence of an umbrella clause in a BIT, a host state could be internationally liable for a breach of a contract according to Art (3)[34] of the ILC articles on responsibility of the states for wrongful acts.[35]

The tribunal then agrees with the concern of the *Pakistan* case that the contract's forum-selection clause would be overridden. Yet it does not accept that this be attributed to the broad interpretation of an umbrella clause since they both have distinct arenas.[36] But as for the fourth argument, which is related to the location of umbrella clause after the "first-order" guarantees, the tribunal stated that the location of the clause is not as decisive as its language.[37]

Many tribunals have adopted that broad interpretation. The *Noble Ventures, Inc. v. Romania* tribunal asserted that an umbrella clause is certainly intended by the parties to "equate contractual obligations governed by municipal law to international

[32] *Id*, para 121.
[33] *Id*, para 128.
[34] It reads "The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law."
[35] *SGS v Philippines*, supranote 24, para 122.
[36] *Id*, para 123.
[37] *Id*, para 124.

treaty obligations as established in the BIT."[38] Moreover, it held that the object and purpose of a BIT and the principle of effectiveness of interpretation requires such an expansionary one, otherwise, an investor would be deprived of "any internationally secured legal remedies in respect of investment contracts that it has entered into with the host state."[39]

The *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc. v. Argentine Republic* tribunal endorsed its understanding to the effect of the umbrella clause to encompass any obligation towards foreign investors whatever their sources are, including those derived from the investor-state contract, stating that these obligations "receive extra protection by virtue of their consideration under the bilateral treaty."[40] The tribunal concluded that the Gas Law and its regulation's provisions, governing the tariff scheme of the claimants' investments, were not just "legal obligations of a general nature," instead they were specifically related to the claimants' investments since they were enacted and introduced by Argentine in the Offering Memorandum for inducing such investments. Hence, the breach of such obligations amounts to a treaty breach under the umbrella clause.[41]

Similarly, the *Siemens A.G. v. The Argentine Republic* tribunal asserted its concurrence with that parties' consent to the wide meaning of "any obligations it has assumed with regard to investments" encompasses any failure to meet obligations undertaken by the treaty parties, including those arising from underlying contracts.[42]

3. Inconsistent methodologies and outcomes:

Ironically, the hallmark awards of both approaches did not get free of criticism by subsequent awards and have been followed by some tribunals but with driftage from their final conclusions. Indeed, tribunals of both approaches criticize each other's conclusion for the same challenge that it transcends what state parties to BITs have consented to and intended to achieve.[43] Moreover, it cannot be assumed that there is a consensus about the methodology of deduction of these approaches. Some tribunals accepted a restrictive interpretation of the umbrella clause, but qualified the claimed

[38] *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, para. 61, (2005).
[39] *Id*, para. 52.
[40] *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on liability, para. 170, (2006).
[41] *Id*, paras. 174-175.
[42] *Siemens A.G. v. The Argentine Republic*, ICSID CASE No. ARB/02/8, Award, paras. 204-206 (2007).
[43] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, para. 203, (2005).

violated breaches to be a treaty one to give effect to the protection of the umbrella clause. On the other hand, as for the expansionary approach, some tribunals have included into the scope of an umbrella clause contractual obligations such as payment, while others have favored obligations assumed through law or regulation.[44] Others have adopted an approach distinguishing between mere commercial contracts and contracts in which a state appears as a sovereign. In another vein, the question of admissibility of a claim in case there is an exclusive jurisdiction clause in the investor-state contract raised another debate.

The *CMS v. Argentina* tribunal started its reasoning regarding the impact of umbrella clauses by asserting that not all contractual breaches constitute a treaty breach. However, an umbrella clause may operate to elevate a contract dispute to a treaty claim if the act of the state amounts to a "significant interference" with the rights of the investor:

> The standard of protection of the treaty will be engaged only when there is a specific breach of treaty rights and obligations or a violation of contract rights protected under the treaty. Purely commercial aspects of a contract might be protected by the treaty in some situations, but the protection is likely to be available when there is significant interference by government or public agencies with the rights of the investor.[45]

The tribunal allegedly stated that the claimed acts were "governmental decisions that have resulted in the interferences and breaches noted."[46] Those claimed interferences related to two stabilization clauses contained in the claimant's license. The first was the obligation not to freeze the tariff regime or subject it to price controls. The second was the obligation not to alter the basic rules governing the License without TGN's written consent. Thereof, the tribunal considered that those interferences were not just of a commercial nature; instead they attain breaches of the treaty standard guarantees:

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[44] *Duke Energy Electroquil Partners & Electroquil S.A. v. Ecuador*, ICSID Case No. ARB/04/19, Award, para. 320, (2008).
[45] *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, para. 299 (2005).
[46] *Id*, para. 301.

> [T]he obligation under the umbrella clause… has not been observed by the Respondent to the extent that the legal and contractual obligations pertinent to the investment have been breached and have resulted in the violation of the standards of protection under the Treaty.[47]

In sum, although the tribunal followed the *SGS v. Pakistan* and *Joy Mining v. Egypt* tribunals in accepting that an umbrella clause is not sufficient on its own to turn contractual breaches to breaches of treaty-based guarantees, it, eventually, gave effect to the umbrella clause but on a vague standard criterion. To illustrate, the license granted to the claimant could be qualified as the contract concluded between the state agency and the investor under municipal law. So, a breach of its clauses is eligible to be regarded a contractual breach as well. Hence, the threshold of determining the rights of the investor, recognized by the tribunal, is still ambiguous, whether they are the general protections and guarantees adopted by the BIT or encompass those arising from the contract too. Practically, the tribunal *inter alias* adopted an expansionary interpretation without declaring that.

On the other hand, as for the expansionary approach, one leading case is the *SGS v. Philippines* whose award has been criticized by other tribunals. Remarkably, the *El Paso v. Argentine* tribunal criticized its outcomes for two shortcomings. The *El Paso* tribunal held that such approach adopted by the *Philippines* tribunal would render the whole treaty useless, since a breach of *any legal* obligation assumed by municipal law, and not only a contractual one, would be "internationalized" and trigger the state responsibility, then the whole protections of the treaty would be superfluous. Moreover, the *El Paso* tribunal aroused the inconsistence of the *Philippines* decision to stay the arbitral proceedings as for determining the amount due. The *El Paso* tribunal stated that it sounded "s*trange*" that the *Philippines* tribunal held that "it has jurisdiction over the contract claims/treaty claims, but at the same time that it does not really have such jurisdiction- until the contract claims are decided."[48]

The mythology and outcome of the *Noble Ventures* tribunal was criticized as well. The tribunal started its deduction by assuring that as a general international law

[47] *Id*, para. 303.
[48] *El Paso v. Argentina*, *supranote* 12, Para. 76.

rule that in normal circumstances a breach of contract does not *per se* give rise to international liability of the state. Thereof, since this rule is not a peremptory one, it can be agreed to the contrary. Then it admitted that an umbrella clause is more like an exception to a general rule, which consequently has to be interpreted in a strict restrictive way:

> [A]n umbrella clause, when included in a bilateral investment treaty, introduces an exception to the general separation of States obligations under municipal and under international law. In consequence, as with any other exception to established general rules of law, the identification of a provision as an "umbrella clause" can as a consequence proceed only from a strict, if not indeed restrictive, interpretation of its terms.[49]

The *El Paso* tribunal faulted the *Noble Ventures* decision for the unreasonableness of its conclusion to effect an expansionary interpretation of umbrella clause after it asserted that it has to be restrictively interpreted.[50]

Another façade of inconsistency in arbitral interpretations of umbrella clauses, especially those adopting the broad interpretation, is the issue of admissibility of the claim before the international arbitral forum in case there is an exclusive jurisdiction clause in the underlying investor-state contract.

This issue was firstly tackled by *Lanco v. Argentina* tribunal which held that "when the parties give their consent to ICSID arbitration, they lose their right to seek to settle the dispute in any other forum, domestic or international."[51] The *SGS v. Philippines* tribunal took a different path by accepting its jurisdiction over a contractual claim and accepted the admissibility of the case before it, however, it decided to "stay the arbitral proceedings pending a decision on the amount due but unpaid under the CISS Agreement" as there were pending proceedings before the municipal tribunals. This approach was as well criticized by the *Bureau Veritas, Inspection, Valuation, Assessment and Control, Bivac BV v. Republic of Paraguay* tribunal that, although adopted an expansionary interpretation of umbrella clauses,

[49] *Noble Ventures, Inc. v. Romania*, *supranote* 32, para. 55.
[50] *El Paso v. Argentina*, *supranote* 12, Para. 77.
[51] *Lanco v. Argentina*, ICSID Case No. ARB/97/6, para. 36.

adopted a more restrictive, conservative one regarding the relation to the contractual forum-selection clause and its impact on the admissibility of the claim.

The *Bureau v.* Paraguay tribunal affirmed that an umbrella clause elevates states' contractual obligations towards investors to the level of international obligations. Hence, the breach of such clauses triggers state international responsibility and "give[s] [the] tribunal jurisdiction to interpret and apply the contract as such."[52] In other words, such a clause would confer on the international forum jurisdiction over all disputes relating to the state-investor contract including payment issues, and the obligation to observe whether the contract-agreed dispute-settlement forum was "available to resolve any "conflict, controversy or claim which arises from or is produced in relation to" the Contract."[53]

In the present case, the contract contained an "exclusive jurisdiction clause" for the resolution of contractual disputes by reference to arbitration under the law of Paraguay. The tribunal held that it was clearly intended to preclude any body other than the Tribunals of the City of Asunción from resolving any dispute "which arises from or is produced in relation to" the Contract clause.[54]

The tribunal reached with its expansionary understanding of umbrella clauses to a higher level relating to determining its superiority vis-à-vis a forum-selection clause in the state-investor contract. Indeed, the tribunal adopted a progressive approach than that of the *SGS v. Philippines* tribunal. It asserted that the parties to the contract are not free to pick and choose whatever they want from the contract provisions to incorporate under the protection of the umbrella clause and ignore others. Therefore, if the state organ is obliged to pay invoices in the scheduled time, the investor is obliged to respect the forum selection clause contained in the contract, so is the BIT forum.[55] Indeed, the tribunal by so doing, it tackled the shortcoming of the *SGS v. Philippines* when decided to "stay the arbitral proceedings pending a decision on the amount due but unpaid under the CISS Agreement." In its reasoning for such an outcome, the tribunal ruled that it:

> [C]annot accept that standard BIT jurisdiction clauses automatically override the binding selection of a forum

[52] *Bureau Veritas, Inspection, Valuation, Assessment and Control, Bivac BV v. Republic of Paraguay* (hereinafter *Bureau v, Paraguay*), ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, paras. 141-142, (2009).
[53] *Id.*
[54] *Id*, para. 145.
[55] *Id*, para. 147.

by the parties to determine their contractual claims. As the ad hoc Committee said in the Vivendi case:

> '[W]here the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract.'[56]

That decision dragged a massive criticism, even dissented by Antonio Crivellaro one of the tribunal's arbitrators, due to the confusion and dual standards it adopted. The *SGS v. Philippines* asserted its jurisdiction over contractual claims under the umbrella clause as an international law issue, and then it failed to follow to its logic result by staying the arbitral procedures until the municipal judiciary decides on the amount due as a contractual issue to be determined by it.

The tribunal shed the light on the inconsistency of the *SGS v. Philippines* decision. After the *SGS v. Philippines* tribunal decided that an umbrella clause in a BIT should have the effect of elevating every contractual breach to a treaty breach and held that it has jurisdiction over the claim, It stated that a party should not be allowed "to rely on a contract as the basis of its claim when the contract itself refers that claim exclusively to another forum", unless there were good reasons such as *force majeure*, preventing the claimant from complying with its contract.[57]

The *SGS* tribunal then in order to overcome the obstacle of the effect of the exclusive forum-selection clause after it has claimed its jurisdiction over the claim based on the umbrella clause, and to go along with its ideology that "treaty jurisdiction is not abrogated by contract,"[58] it considered the issue of resorting to the contractual forum is an issue of admissibility. It concluded that:

> Normally a claim which is within jurisdiction but inadmissible (e.g., on grounds of failure to exhaust local remedies) will be dismissed, although this will usually be without prejudice to the right of the claimant to start new proceedings if the obstacle to admissibility has

[56] *SGS v Philippines*, supranote 24, para 153.
[57] *Id*, para. 154.
[58] *Id.*

> been removed (e.g., through exhaustion of local remedies).[59]

Indeed, I believe that the *Philippines* tribunal felt reluctant to dismiss the case after it decided to claim jurisdiction over the contractual claim. The *Bureau* tribunal criticized this outcome on the basis that once a tribunal accepted jurisdiction over a claim, it should resolve all its relevant issue. However, in case that there is an exclusive jurisdiction clause in the state-investor contract, this would render the case inadmissible for the non-fulfillment of the obligation to exhaustion of local remedies:

> [i]f the parties to the contract have agreed on an exclusive jurisdiction to resolve a dispute under the contract, whether it relates to the amount that is to be paid or the justifications raised by one party for non payment, then it is exclusively for that forum to resolve all aspects of the dispute under the exclusive jurisdiction clause. If any agreement between the parties on the amounts outstanding under the contract does not resolve the contractual dispute, then exclusive jurisdiction continues to vest in the agreed forum and the ICSID tribunal is barred from exercising jurisdiction.[60]

Amongst other reasons, The *Bureau* tribunal held that the umbrella clause in the BIT dose not override the exclusive jurisdiction clause of the contract, and for the preserve of the autonomy of the contract for the purpose that a claimant "cannot rely on the Contract as the basis of a claim under (the umbrella clause) of the BIT when the Contract itself refers that claim exclusively to another forum (emphasis added)," it decided that the case was inadmissible.[61]

In conclusion, no concrete or ultimate interpretation could be attained for either approach. Some tribunals that preferred such a restrictive interpretation, ended up with giving effect to the umbrella clause through qualifying the breaches as treaty ones (e.g. the *CMS v. Argentine*). Even those tribunals that accepted an expansive understanding for an umbrella clause diverged as to its scope and its superiority to a

[59] *Id*, para. 171.
[60] *Bureau v, Paraguay*, *supranote* 32, para. 154.
[61] *Id*, para. 159.

contractual forum-selection clause. As for the scope; some tribunals limited the expansive umbrella to the contractual breaches (e.g. *SG v. Philippines*), others expanded it to all legal obligations assumed by the host state (e.g. *LG&E Energy Corp v. Argentine*). As for its effect vis-à-vis an exclusive jurisdiction contractual forum clause and its impact to the admissibility of the international arbitral case, such an expansive approach of the effect of umbrella clause has been gradually deteriorated vis-à-vis the contractual forum-selection clause for the benefit of the autonomy of the investor-state contract.

In sum, seeking an ultimate and irrevocable interpretation is unattainable. Either approach can be reached using the same tools of interpretation. Although every tribunal is guided in its mission by the object and purpose of the BIT in order to attain the real intentions of the parties, they end up with completely contradictory interpretations. Even those who adopt the same ideology end up using different methodologies and may end in diverse outcomes.

III. The bigger picture:

The issue of interpreting umbrella clauses shall be examined on a macro level rather than limiting it to the microscopic view of whether it avail a greater protection for investors.[62] In other words, this dilemma represents a pragmatic façade of the interpretation conundrum. Any interpreter's main goal is to reveal the subjective consent of the parties using the possible objective indications. Although the path is the same, the outcomes are not guaranteed to be united. An interpreter may end up with the conclusion that the state parties consented to bring contractual breaches to the level of treaty breach. Yet, it might transcend their consent. On the other hand, an interpreter may prioritize considerations of justice and reciprocity, by demonstrating its closeness to what the states had in mind during the conclusion of the BIT, which, in turn, may lead to a non-consensual interpretation. The split in tribunals' jurisprudence triggered a lot of literature debate, which on its turn fell in this infinite debatable circle for the purpose of revealing what is actually intended by umbrella clauses.

The main starting point to be handled is that whatever the outcome of interpretation and the ideologies of interpreters, whether they adopt a naturalist or positivist ideology, they follow the same path drawn through Article 31of the Vienna convention on the law of treaties. Hence, detecting possible solutions to the dilemma of the inconsistency of investment arbitral awards should start by dictating whether the path laid down in Article 31 of the VCLT could provide a concrete and solid basis with clear results if being properly followed. This chapter argues that there is no such a proper application of interpretation rules that could assure an anticipated outcome due to the vagueness and broadness of such rules.

A. The Vienna Convention Path:

Article 31 (1) of the VCLT stipulates that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." This paragraph lays down three principles of interpretation; first is to interpret a treaty in good faith. The second principle is that an interpretation has to reflect the ordinary meaning of the text. The third principle is that this ordinary meaning has to be determined in the light of the text, context and the object and purpose of a treaty.

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[62] Jaemin Lee, *Putting a Square Peg into a Round Hole - Assessment of the Umbrella Clause from the Perspective of Public International Law*, 14 Chinese J. Int'l L. 341, 341 (2015).

First, Good faith works as a general guideline to choose between two or more competing meanings of the same treaty provision.[63] As well, it provides a guideline for the application of a treaty by both parties that it should be applied in a manner that proves the good faith of each party to observe their obligations. Vividly, this criterion does not propose a concrete basis or a module for it should be considered an application in good faith or not.

Second, the ordinary meaning of the terms of a treaty should be considered in an interpretation process. Interpreters shall consider the ordinary meaning of treaty texts unless the parties explicitly intend to adopt a special meaning.[64] Indeed, despite the fact that the VCLT articulates revealing the ordinary meaning of treaty texts as a means, it represents a goal rather than a means. In other words, the terms of a clause could be drafted in a way that does not infer any special meaning, yet the parties claim different ordinary meanings to be what they consented to.

Third, treaty terms shall not be interpreted separately. However, it shall be interpreted in the light of the context of the treaty as a whole. A greater look should be considered to all the treaty elements stipulated in article 31 of the VCLT. These elements include the preamble, the annex, any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty, and any instrument, which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. However, indications of these elements are subject to the discretion of an interpreter and may not provide a concrete objective indication to the parties' actual consent.

Forth, the object and purpose of a treaty represent the most apparent and desirable guideline in the process of interpretation. They do not represent an independent means of interpretation, yet there is an inextricable relation between the object and purpose of a treaty and the ordinary meaning of its terms. Indeed, the ordinary meaning of treaty terms could be modified and altered from one to another according to the object and purpose of each treaty.[65] In fact, important as it may appear, the parties to a treaty may embark upon concluding a treaty with different

[63] Trinh Hai Yen, THE INTERPRETATION OF INVESTMENT TREATIES, 9 (Loretta Malintoppi & Eduardo Valencia-Ospina. eds., BRILL, 2014), 44.
[64] Ulf Linderfalk, *Is Treaty Interpretation an Art or a Science? International Law and Rational Decision Making*, 26 European Journal of International Law 169, 171 (2015).
[65] Richard Gardiner, TREATY INTERPRETATION, 27 (2nd edition, the Oxford International Law Library, 2008) 190.

objectives and purposes. Investment treaties resemble a remarkable example in this instance. An investor may claim that the main purpose of an investment treaty was to induce investments and provide more guarantees for them however; a host state may claim that the superior object of any international treaty shall not jeopardize a state sovereignty. Therefore, the means laid down by the VCLT would constitute a backlash to the conformity of the interpretation process as such.

Article (32) of the VCLT enumerates other means of as "supplementary methods" of interpretation. It stipulates that "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion,…" using the term "including" indicates that these means are not exhaustive to certain ones, and it avails a wide discretionary power for interpreters to resort to these means or any other ones that seem to be beneficial on a case-by-case basis.

According to that article, the preparatory work (*travaux preparatoires*) of a treaty could be used as a constructional start for applying the general rules and paths of interpretation or as an indicator for dictating that the outcome was properly deduced if it was ambiguous or absurd. The dilemma is that there is no neither a definitive nor a conclusive definition for the preparatory work of a treaty.[66] Therefore, these works, whatever they are, could not be highly reliable because certain documents or recollections on the intended meaning of umbrella clauses are neither contemporaneous authoritative records of drafting history nor clearly independent of interest in pending disputes.[67] Similarly, the circumstances of the conclusion of a treaty do not propose a reliable mean for a definitive interpretation. They may include the contemporary circumstances and the historical context of the conclusion of the treaty[68] which by their turn are subject to the discretion of the interpreters.

In conclusion, the path provided by the Vienna Convention does propose neither a definitive nor a reliable means for interpretation. Although the ultimate purpose of an interpreter is to figure out the actual mutual intentions of the parties to a

[66] VIENNA CONVENTION ON THE LAW OF TREATIES: A COMMENTARY 541 (Oliver Dörr & Kirsten Schmalenbach eds., Springer, 2012), 574.
[67] See letter dated 1 October 2003 from Ambassador Marino Baldi, of the Swiss Secretariat of Economic
Affairs, to Antonio R. Parra, Deputy-Secretary General, ICSID entitled 'Umbrella Clauses in Bilateral Investment Treaties' reprinted (2004) 19 *Medley's Intl. Arb. Rep.*
[68] *Supra note* 66.

treaty using objective methods, the VCLT rules of interpretation are so much vague and wide that still be affected by interpreter's subjective perspectives.

Indeed, klabbders regards the process of interpretation as a highly political act on the basis that interpretation's main function is to reveal the meaning of words used in treaties in order to delimit the rights and duties of each party.[69] Consequently, he claims that interpretation cannot be subjected to governing rules on the basis that these rules could be ignored, distorted or manipulated in actual use, either by design or actual ignorance. Many valid interpretations could be reached using the same interpretation tools resulting in a political conflict, the same conflict intended to be avoided through the inclusion of interpretation rules.[70] He elaborates that readers make much of their own stories to the extent that one can say interpretation depends not so much on what the author puts into, but rather on what an interpreter takes out.[71] Interpreters may jump to conclusions of their own making which may reflect their ideologies, cultures, experiences, background assumptions and understanding of things that may be totally different from that of the original author.

In a nut shell, although the attempt to govern interpretation by rules was aimed to rationalize and depoliticize that conduct, I believe that interpretation rules laid down by the VCLT does not put an end to its political character.

B. Interpretation discourse falling into the loop of subjective consent *v.* objective justice:

Sources of international law doctrine used to be a playground for a tremendous debate about the basis of law's obligatory nature. These dichotomies originate from the basic naturalism/positivism dichotomy which is premised on the binary of justice/consent. Modern discourse tries to reach reconciliation by proposing moderate doctrines.[72] The progress of such discourse from the orthodox to the modern is what matters for the purposes of this research.

The orthodox view of sources dichotomy considers the state consent as the very source to be obliged by what it committed to. This view was widely challenged on many bases. First, eliminating threshold between state's will and law jeopardizes

[69] *See* Jan Klabbers, *Virtuous Interpretation*, in TREATY INTERPRETATION AND THE VIENNA CONVENTION ON THE LAW OF TREATIES: 30 YEARS ON 24, (Leiden.Boston) (2010).
[70] *Id.* at 416.
[71] *Id.* at 22-23.
[72] *See* MARTTI KOSKENNIEMI, FROM APOLOGY TO UTOPIA 16-17, (Cambridge University Press) (2004).

law's ascertainment and results in an apologist system as it does not provide a concrete basis for the obligation of non-consenting states. Second, it does not tell where to deduce the consent of states especially on such a totalitarian level like the international community. Third, this doctrine lapses in a logical dilemma that such a consensual obligation presupposes the existence of a non-consensual rule that invests consent with that law-creating effect.[73]

For such challenges and in order to avoid them, modern scholars have proposed doctrines for law's obligation distinct from consensualism like social and economic necessities, e.g. the need of living in an organized society. However, as koskenniemi puts it, this modern doctrine has not been more successful as its predecessor on the basis of its ambiguity in terms of on what basis to derive normative rules from such general concepts. He argues that this new discourse showed the irony of things as naturalists (non-consensualists), by invoking social and extralegal needs as a basis for the abidingness of the law, became positivists (consensualists).[74] To illustrate, inasmuch as these criteria are vague, its determination is dependent on what states believe they are their interests. Hence, it is back to the will and *consent* of the states.

Koskenniemi claims that it is "interminable circle" where consensualism is needed to provide for law's concreteness, i.e. law should reflect state's interests. Simultaneously, non-consensualism is needed since it provides a basis for law's normativity, which refers to law being binding even in cases opposing interests of some states.[75] The irony is that on the one hand, a positivist perspective supposes an ascending justification based on the pure consent and elevating it to something more, which is being obliged by something that overrules that consent, resulting in denying its starting point. On the other hand, a naturalist perspective adopts a descending justification giving the priority to justice by demonstrating its closeness to consent, yet that in turn leads to a non-consensual outcome.[76]

The main argument of this paper is that interpretation is conducted in no much better way than that irony. As koskniemi puts it, most doctrines explain

[73] *Id*, at 311.
[74] *Id*, at 315.
[75] *Id*, at 321.
[76] *Id*, at 309.

interpretation as a utility to give texts its normal or ordinary meaning. Article 31 of the VCLT adopts the same ideology by referring to the "ordinary meaning to be given to the terms." He, however, claims that this doctrine starts with what is supposed to be ended with.[77]

On the one hand, determining the ordinary or normal meaning of texts is the very debatable point so much so that it cannot be regarded as a concrete *given* starting point. On the other hand, either weighing subjective or objective understanding of a text could discard the normal meaning of a text. First, if the intent of the parties was so clear that it cannot be dismissed, then this mutual consent overrules any probable meaning of the text. Second, if the objective considerations (e.g. justice and reciprocity) were preferred, then the ordinary meaning of a text would be secondary. Therefore, the normal meaning doctrine does not provide a conclusive and a concrete theory for interpretation which returns to the very debate about the choice between subjectivity and objectivity.

The irony about interpretation is that both subjectivity and objectivity overlaps. Interpretation, in general, is a method to figure out the actual intent of the parties; hence, this intent cannot be used as a starting point for attaining it. This intent could be deduced from the text, subsequent conduct and good faith. In other words, back to the irony, it could be concluded from other objective clues. Here lies the dilemma, as an interpreter's goal, even overwhelmed by an *objective* ideology, is to deduce the parties' *subjective* intent. So, at the end, to either would the credit be attributed, the subjective or the objective approach? Moreover, in the end, by what means could it be guaranteed that the conclusion of interpretation represents what the parties have actually consented to? Eventually, the justification would be of the interpreter not the parties,[78] so it is subjective anyway.

The drafting of article 31 of the VCLT itself manifests this irony. Koskenniemi claims that it adopts all possible thinkable ideologies of interpretation so much so that it resembles a compromise between the subjective and objective ones.[79] It starts with adopting objective indications for interpretation by stating that "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given

[77] *Id*, at 333-334.
[78] *Id*, at 336.
[79] *Id*.

to the terms of the treaty in their context and in the light of its object and purpose." This provision indicates that a text shall be interpreted in the light of objective standards but as a *means* in order to attain the subjective intent of the parties. As a consequence, this provision escalates the parties' intent, so it provides in paragraph 4 that "A special meaning shall be given to a term *if it is established* that the parties so intended (emphasis added)." The dilemma lies in determining how to be established that the parties intended a special meaning other than the ordinary one. Would it be the statement of the party (a subjective standard) or the tribunal's justification? And if it were estimated by the tribunal, on what basis would it justify its conclusion in opposition to the intent of the party concerned? Would it be on an objective basis (like justice, natural law principles and reciprocity) which will dissipate the parties' consent which is the essence of interpretation? Or would it be on the basis that the tribunal "knows better" which would raise doubts about its political character? In a nutshell, it is like going through an infinite circle.

In conclusion, interpretation could start with an ideology and ends with the contrary. Its main goal is to figure out the parties' subjective intent using available objective manifestations. However, an interpreter may reach a conclusion assuming that it is what the parties consented to. Yet, it might transcend that consent, resulting in denying its starting point. On the other hand, an interpreter may prioritize considerations of justice, assuming its closeness to consent, which may simultaneously lead to a non-consensual outcome. Although different outcomes may be rendered, the irony is that the same path is followed using the same tools. Neither outcome can stand alone as a concrete and lone basis for interpretation. Moreover, neither can be alleged to be the ultimate legitimately justified one.

C. Umbrella clauses as a façade of the interpretation conundrum:

As previously mentioned, the primary purpose of the insertion of umbrella clauses was to elevate a contract between an investor and a host state to the level of an inter-state obligation between the host state and the national state of the investor.[80] Afterwards, BITs used to include these clauses, but the question arises about what states actually intended to accomplish by inserting such clauses. In other words, do all states accept the insertion of an umbrella clause in a BIT for the purposes of attracting

[80] Anthony C. Sinclair, *Supra note 3*.

foreign investment with full acceptance of its possible impacts on state sovereignty, or do they intend to maintain some sort of balance between state sovereignty and protecting investors' rights?

Many scholars argue for an expansionary interpretation of umbrella clauses. Weil argues that the effect of an umbrella treaty is to turn the obligation to perform the contract into an international obligation at the charge of the contracting State vis-à-vis the national State of the co-contracting party. Therefore, this gives rise to the international liability of the state violating its contractual obligations and invests the international forum established by the BIT with jurisdiction to adjudicate such disputes.[81]

Mann claims that the object of an umbrella clause is to guarantee the success of the investment by providing the investors with protection against any interference with their contractual rights, whether this interference was a contractual breach or a legislative or administrative act of the host state.[82] Hence, it raises the international liability of the host state if it happened not to observe its contractual obligations with them.

Schill supports an unlimited and expansionary effect of umbrella clauses but on a different basis. He sets aside the "contract claim- treaty claim" distinction adopted by the narrower approach. Instead, he attributes its substance to the public law norm *pacta sunt servanda* according to which a host state will be obliged to preserve the investor's interests against any interference whatsoever. Consequently, apart from any traditional differentiation between a contract and a treaty obligation, an investor will be eligible to resort to the international arbitral forum for any breach by the host state.[83]

Scill proposes three arguments for the expansionary interpretation of an umbrella clause. First, he claims that the *plain* interpretation of such clauses requires the host state to observe its obligations vis-à-vis the investors independent of whether its conduct is a commercial or a sovereign one. Second, he argues that this

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[81] P. Weil, *Problèmes relatifs aux contrats passes entre un état et un particulier*, 128 Recueil des Cours III (1969), referred to at Christoph Shreuer, *Travelling the BIT Route : Of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 JWIT 231, 250-251 (2004).

[82] F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 British Yearbook of International
Law 241, 246 (1981).

[83] *See* Stephan W. Schill, *Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties*, 18 MINN. J. INT'l L. 1 (2009).

interpretation is the one to give effect to the clause. Otherwise, an umbrella clause would be superfluous as it would replicate the obligations of the states to protect investor-state contracts against any sovereign interference by the state, e.g. the prohibition of expropriation without compensation. Third, this interpretation complies with the object and purpose of investment treaties as such which is for the protection of investors' rights.

Scill refutes the narrower approach's ideology regarding limiting state's international liability to sovereign acts. He elaborates the narrower approach deduction which is based on the fact that an investor is not a subject of international law, and the investor's nationality state is not a party to the contract. So, in order for a host state to be internationally liable for a commercial act violating the investor-state contract, there should be a breach of international law. Thereof, the state's conduct shall constitute a tort under international law.

Schill, on the contrary, claims that this distinction is not convincing for many reasons. First, delimiting a threshold between sovereign and commercial act is unrecognizable. He claims that the actual incentive for an investor to embark upon an investment is the promises and guarantees made by the host state against any interference. A state conduct, on the other hand, can be recognized as a sovereign and a commercial one at the same time resulting in gaps in the protection expected by the investor. Second, he argues that both sovereign and commercial acts can be attributed to the host state constituting an internationally wrongful act according to Article 4 of the ILC articles on state responsibility.

Similarly, Wälde argues that the *plain* meaning of an umbrella clause and the object and purpose of investment treaty mandates the protection of investors' rights against any interference by the host state. He argues that despite that the exact meaning of such clauses is not decisive, they are logically meant to add something to - rather than subtract from- the investors' protection recognized by customary international law. To illustrate, he attributes the authority of such clause to the international-law principle *pacta sunt servanda* according to which the state parties to the treaty consented to grant investors with extra protection. He describes the inclusion of such clauses as a "progressive codification."[84]

[84] Thomas W. Wälde, *The "Umbrella" Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases*, 6 JWIT 183, 206 (2005).

Wälde attributes the contest about the effect of umbrella clauses to the old debate between the NIEO and liberal advocates. The proponents of the so called "New international Economic order," abbreviated as "NIEO," escalate the state sovereignty so much so that it has the power to abrogate contracts depending on domestic laws. On the other end of spectrum, liberal calls proliferated in response to the need for international commerce under "good governance" for the realization of a prosperous "global economy."[85] He claims that the narrower interpretation of such clauses is just a replication of the radical NIEO advocates who argued for the "absolute sovereignty" of the state according to which "a state does no wrong," and an investor-state contract is not a subject of international law. Hence, in their view, a breach of such a contract does not trigger international liability. Wälde criticizes this argument on the basis that the moment a contract is a part of an investment arrangement; it implicates the involvement of governmental powers in this overall process. Consequently, a breach of any part of such conduct is likely to be seen as a breach of international law.[86]

Reluctantly, Shreuer argues that the expansive interpretation adopted in *SGS v. Philippines* is preferable to the narrower one as "it does justice to a clause that is evidently designed to add extra protection for the investor."[87] In spite of that, he admits that a problem still arises if investors tend to use umbrella clauses for trivial disputes. He argues that even if umbrella clauses' object is to infer extra protection for foreign investors, it is not their function to turn every minor disagreement on a detail of contract performance (like payment delays or lease disputes) into a basis for an international arbitration claim. Ironically, he argue that arbitral tribunals should be qualified to develop their standards of interpreting BITs in order to achieve justice between the legitimate expectations of the investors, and the concerns of the host states.[88]

On the other hand, Sornarajah argues that expansionary arbitral awards have extended the states' commitments beyond their consent. Moreover, he claims that foreign investment used to be a means of exploitation of the resources of host states. He argues that what recent academics claim for the emergence of universally binding

[85] *Id*, at 184.
[86] *Id*, at 219.
[87] Christoph Shreuer, *Travelling the BIT Route : Of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 JWIT 231, 255 (2004).
[88] *Id*, 255-256.

principles of investment protection is a myth. Rather, these efforts represent conservation for absolute protection for foreign investors that has been articulated during the neo-liberalism.[89] However, acknowledging absolute and unregulated guarantees for foreign investments have adverse effects on the environment, human rights and labor standards.[90]

Moreover, he claims that the proliferation of BITs, as a consequence of neo-liberalism, has witnessed a retreat due to the realization of developing states of the massive defects of international investment arbitration. He explains that due to the questions about the benefits for entering into investment treaties, many states have withdrawn from the system, like some Latin American states that withdrew from ICSID. Others drafted treaties that limited the scope of investment protection by inserting provisions justifying state inferences with foreign investments.[91] For instance, Australia declared that its future treaties will not include investor-state arbitration.[92]

In sum, it is worthy to notice that both approaches rely –whether explicitly or impliedly- on the autonomy of contracts and the *pacta sunt servanda* principle to argue for their conclusions. Proponents of expansive interpretation of investment treaties -usually capital-exporting states- tend to reduce legal arguments based on the NIEO positions, that is the exclusion of international law and accountability for acts by (mainly Third World) governments. The *pacta sunt servanda* principle presents a reliable counter-argument to assert that governments have an international duty not to rely on governmental powers to violate contracts concluded with foreign investors.[93]

On the other hand, the narrower approach supporters argue that an expansive interpretation of umbrella clause, so much so that it incorporates contractual breaches, jeopardizes the autonomy of contract. Indeed, tribunals that adopted the expansive interpretation were faced with the clash between such an expansionary approach and the privity of contracts regarding exclusive jurisdiction clauses until it was fairly handled with the *Bureau v. Paraguay* tribunal.

This irony reveals the similar paths both approaches pursue. Consequently, it is not surprising that a positivist could infer from the wording of an umbrella clause

[89] Muthucumaraswamy Sornarajah, *Mutations of Neo-Liberalism in International Investment Law*, 3 TRADE L. & DEV. 203, 209 (2011).
[90] *Id*, at 205.
[91] *Id*, at 215-217.
[92] *Id*, at 228.
[93] Wälde, *supranote* 61, at 218-219.

that it is intended for imposing extra level of protection. Many indications could be used to confirm that deduction. For instance, the object and purpose of an investment treaty is to provide protections so much so that it could generate a convenient environment for investment. Thereof, a positivist may employ these indications so as to argue that the *pacta sunt servanda* principle mandates that states have consented to such a clause and renounced some of their rights for another benefit which is attracting much more capital flow.

On the other hand, a naturalist may consider this outcome as transcending the consent of state parties themselves. However, a naturalist may argue that principles of natural law and justice, e.g. good faith and reciprocity, require not exaggerating in interpreting what is already an exception. Moreover, the *pacta sunt servanda* principle requires maintaining the autonomy of the underlying investor-state contract.

In conclusion, figuring out the righteous mutual intent to which the parties consented to is a matter a myth. This may lead interpreters to fall into a loop that may never end to a consensual or plausible end to either party and this is the nature of interpretation. Therefore, as long as this is an inevitable end, many scholars have attempted to propose suggested solutions to meet these ironies seeking for much more conformity and consistency for the credibility of the system as a whole and this is what would be considered in the next chapter.

IV. Possible solutions:

A human conduct as such, interpretation, even governed by rules, is still be affected by the ideologies of interpreters. As previously construed, the outcome of an umbrella clause could be differed from a positivist to a naturalist, although interpreters follow the same path and methods. In response, some authors suggested some solutions in order to attain consistency among arbitral awards. This chapter argues that neither solution can stand alone as a sole or perfect solution for consistency. However, the very point has to be instituting a permanent body for investment disputes with a system of appointing arbitrators by the states rather than involving the investors in the appointment process. This proposal, alongside with balancing the drafting of investment treaties and inserting public law conceptions like proportionality, could result in a remarkable consistency and sufficiency of the system.

A. Eliminating disputed clauses:

The first and foremost solution that may be suggested for reforming investor-state arbitration system would be eliminating disputed clauses. As for umbrella clauses are concerned, some states tended to exclude umbrella clauses out of their treaties and model BITs, in an attempt to make sure that only international law principles are protected and not merely contractual obligations.[94] For instance, the US, France, Canada, and Colombia have adopted model BITs that do not contain an umbrella clause.[95] Moreover, multilateral treaties, such as NAFTA, the ASEAN–Australia–New Zealand Free Trade Agreement, the EU–Canada CETA, and the EU–United States Transatlantic Trade and Investment Partnership (TTIP) have excluded such clauses.[96]

Indeed, the significance of insertion of such clauses cannot be totally neglected. As previously discussed, the first inclusion of an umbrella clause was aimed to guarantee a higher level of protection for foreign investors. Away from the arbitral abuse of these validities by investors by resorting to international arbitration for every contractual breach, the existence of such a clause is a must to confront any arbitral intervention by the host states. Eventually, these clauses were proposed in order to encourage the flow of foreign direct investment (FDI). Hence, these clauses have, and actually are, still being existed "[to advance] towards the development of

[94] Rau´l Pereira de Souza Fleury, *Umbrella clauses: a trend towards its elimination*, 31 Arbitration International 679, 679 (2015).
[95] *Id*, at 680.
[96] *Id*, at 689.

international investment law in general, the formulation of commonly accepted functional standards acknowledged both by investors and host countries, which are then consistently and uniformly applied, will be invaluable to reduce or eliminate the present uncertainty in the outcomes."[97] For such reasons, some fund and investment exporter countries, like German and Switzerland, are strictly proponent of umbrella clauses and kept them in their models.[98] Therefore, reforming the drafting of the clause, along with the institution of a single adjudication body could develop much more accepted standards whose application by an impartial centralized body could reduce the inconsistency of the system.

B. Drafting reform:

The drafting of an umbrella clause that commonly contains *the undertaking to observe any commitments it enters with the investor of the other state* plays an integral role in creating the dilemma. As previously illustrated, figuring out the mutual intention to which the state parties have consented to is a subjective matter that may differ from an interpreter to another. That broad drafting raises questions regarding the limits of the state regulatory power. A reform of the draft may be inserted to include that investors protection shall not restrict the host state's regulatory power.

The European Union and the United states have entered into negotiations regarding a proposed trade agreement named "The Transatlantic Trade and Investment Partnership (TTIP)." According to this system reforms are to be integrated to the whole process starting from the very moment of concluding treaties. In particular, this model asserts the protection of the rights of investors but with a considerable recognition of states' regulatory power. The TTIP proposal states that investment protection "shall not affect the right of the Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social protection or promotion and protection of cultural diversity."[99]

Indeed, as balanced as it seems to be, the dilemma still exists. No matter how precise the draft is, interpretation process does not provide nor guarantee specific outcomes. As for the mentioned example, the clause recognizes the right of the Parties to regulate within their territories through measures *necessary* to achieve *legitimate*

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[97] Srilal M Perera, *Equity-Based Decision-Making and the Fair and Equitable Treatment Standard: Lessons from the Argentine Investment Disputes*, 13 J World Investment & Trade 442, 485 (2012).
[98] *Id*, at 691.
[99] TTIP Proposal, sec. 2, art. 2.1.

policy objectives. In fact, determining the gravity of the circumstances causing the undertaken measures would be subject to the discretion of the adjudicators. Likewise, detecting the necessity and properity of these measures will be debatable among disputing parties to which the draft, whatsoever, do not provide clear and cut limits. In a nut shell, adjudicators will fall into the loop of the interpretation conundrum in spite of how detailed the draft is.

C. Inserting public law concepts:

A significant aspect of investing foreign investors with great facilities and protections in investment treaties is limiting the treaty purpose to investors' protection without addressing a comprehensive view of state regulation power. As a consequence, such a pro-investor perspective has led to neglecting any potential protection and consideration of the regulatory power of the host states. Such power, beyond expropriation and nationalization, regarding such as provision of public goods and services, and public order maintenance, should be considered in order to accomplish some sort of balance between these interests and protecting investors' rights.[100] Public law concepts can be permitted in interpretation in order to balance investors' rights and rights-limiting policy choices.[101] This proposal is not a means per se, yet a methodology of thought that could rebalance the disputed interests alongside with balanced draft and through a permanent body of state appointed adjudicators.

Many standards could stem from public law jurisdiction. Proportionality represents a significant method in order to attain balance between conflicting interests. Proportionality stands as a method of interpretation that seeks balance between rights and right-limiting policies. Its methodology is based on assessing competing legal claims, weighing them, considering alternatives following some limits, tests or standards to be met in order to attain such balance. It considers some elements in the path of evaluating the gravity of means followed by a state and its compatibility with the purposes aimed to be achieved. A proportionality analysis

[100] *See* William Burke-White & Andreas Von Staden, *The Need for Public Law Standards of Review in Investor-State Arbitrations, in* Stephan W. Schill, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW, 689, (Oxford University Press, 2010).

[101] *See* Stephan W. Schill et. al, *Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in The Public Interest- The Concept of Proportionality, in* Stephan W. Schill, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW, 75, (Oxford University Press, 2010).

could be deduced through some tests, such as suitability, necessity and proportionality *stricto sensu*.[102]

Indeed, a significant step in order to mitigate privatization of investor-state arbitration system is to confer some consideration on state regulatory power. Public law methods applied by state-appointed adjudicators could be successful in delineating and balancing the conflicting interests of international legal order and domestic public policy.

D. A permanent international court for foreign investment disputes: A tendency for establishing a permanent international court for foreign investment disputes has evolved among scholars for confronting the legitimacy crisis of the investor-state arbitration system.[103] The main purpose of such a project is for allowing states alone to determine the composition of the bench. Investing the states with the power to appoint tenured adjudicators raise the chances of their independence and impartiality as they will not cater for more financial interests by possible future nominations by their appointers. Fixing the adjudicators salaries will increase their impartiality and fairness for the ultimate good of the system.

Instituting a centralized permanent court will play an integrated role in reducing inconsistency in arbitral awards through centralizing control over interpretation and application of investment treaty within a single appellate body.[104] The significance of such a project can be highlighted by detecting the flaws of existing arbitral systems, such as ICSID. Although ICSID entails parties to file an annulment request before an *ad hoc* committee that is appointed entirely by ICSID, the annulment cannot be based on legal merits. The annulment can only be filed for five exclusive grounds which share in common a review of the procedural prosperity of the award. When ICSID arbitration was first being tested, there was a tendency to broaden the bases of review in order to reexamine the substantive merits of the case. Subsequent *ad hoc* committees, however, confirmed the limited nature of review.[105] Establishing a permanent court would include an appellate body which in turn expands the bases of review on legal bases contributing in achieving consistency and

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[102] *Id*.
[103] *See* G Van Harten, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007) 180-184.
[104] *See* Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1585 (2005).
[105] *See generally* Christoph H. Schreuer, The ICSID Convention: A Commentary (2001).

harmony in the arbitral awards and honoring the credibility and predictability of the system as a whole.

This tendency cannot be free from critics. Instituting an appellate body may not guarantee a permanent and conventional jurisprudence regarding the interpretation and application of investment treaties. However, the desirable purpose of such a permanent body is not to eliminate inconsistency, because it is almost impossible due to the nature of interpretation and the adjudication process itself. The main goal is to reduce that inconsistency.

E. The EU model:

In order to confront and overhaul the flaws of the investor-state arbitration system including the exceptional legal privileges that entail individual investors to sue states directly for compensatory damages before an international tribunal and the inconsistency of its awards, the EU proposed in 2015 the new investment court system (ICS). This system was to be first applied to the EU free trade agreements with Canada (CETA) and Vietnam (EU-Vietnam FTA).[106] According to (ICS), decisions regarding investment disputes are no longer made by arbitration tribunals constituted of private arbitrators appointed by the disputing parties but rather by bilateral investment courts staffed with public judges appointed for a fixed term by states.[107] This system is anticipated to be the first seed for a permanent investment court to reform the flaws of the investor-state arbitration system.[108]

The European model's main pillar is to establish an appellate body of permanent tenured, state appointed judges whose wages are fixed which insures the impartiality of judges. Moreover, investing the judges' appointment in states mitigates the privatization of the investment arbitral system and infers public law characterization which tends to attaining possible balance between investors' protection and states' regulation right. In addition, a second instance on legal merits and not exclusive to formal review procedures like ICSID plays an integral role in reducing inconsistency in arbitral awards.

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[106] *See* Thomas Dietza, et al., *The legitimacy crisis of investor-state arbitration and the new EU investment court system*, 26 Review of International Political Economy 749, (2019).
[107] *Id*, at 750.
[108] European Commission. (2018). A multilateral investment court: A contribution to the conversation about reform of investment dispute settlement [Speech by Cecilia MalmstrÖm]. Retrieved from http://trade.ec.europa.eu/doclib/docs/2018/november/tradoc_157512.pdf

V. Conclusion:

Detecting the actual consent of a treaty parties will always be like chasing a mirage. Either outcome could be criticized to be beyond what state parties actually consented to. Accusing the system to be biased is itself a superficial fallacy because a human conduct can never be predicted and will always be an open-ended path. Umbrella clauses stand as a façade of that conundrum where no one can negate its virtuous and prosperous purpose. However, expanding its impact could result in an outcome beyond actual consent.

This paper suggests some solutions for such a problem. However, neither proposed attempt can provide an absolute solution for the consistency or the impartiality of the system. Since the interpretation process and its outcome cannot be governed and still affected by *subjective* ideologies, reforming the adjudicating body through applying *objective* appointing standards could diminish the privatization of the system and neutralize its function. Cleansing the system of political considerations is a legitimate purpose for the neutrality and consistency of the system. The very starting point on the reform path should be instituting a permanent court for foreign investment. Moreover, reforming the appointing system of the arbitrators and invest it in the hands of the state parties not to investors is a necessity for their impartiality.

The purpose is to mitigate the political symptoms of the system and its inconsistent awards because attaining a perfect consistent system is not feasible even with a single appellate body. A court of appeal may shift its tendency in some legal issues over time. However, inserting balanced drafting reforms in investment treaties to be interpreted by state appointed tenured judges using public law concepts like proportionality to attain balance between conflicting interests will have a great effect in reducing inconsistent awards and grow much more credibility for the system.