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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 by S.A. Alexandrov

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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

Stanimir A. ALEXANDROV*

I. INTRODUCTION

Foreign investments are often made through a contract between a foreign investor and an entity or instrumentality of the host State. The promotion and protection of such investments is consistent with the object and purpose of investment treaties. In numerous cases, disputes between investors and host States under investment treaties arise out of breaches of underlying contracts. Public information regarding these arbitrations is limited. A quick review of the International Centre for Settlement of Investment Disputes (ICSID) sources suggests, however, that in approximately ninety to one hundred cases registered with ICSID since 1 January 1997, ICSID jurisdiction was asserted based on a provision in an investment treaty and roughly one half of them appear to have involved underlying contractual breaches.

The recent decisions of the ICSID Tribunals in *SGS v. Pakistan*[1] and *SGS v. Philippines*[2] have brought to the forefront the question as to whether an international arbitration tribunal constituted under an investment treaty has the authority to exercise jurisdiction over claims for breaches of a contract between a foreign investor and a State.[3] These Decisions have been the subject of ongoing discussions as a result of the two Tribunals' contradictory holdings on this issue.

This article focuses on the different rulings of the *SGS v. Pakistan* and *SGS v. Philippines* Tribunals with respect to two questions:

(i) whether a breach of contract by the State will constitute a breach of the investment treaty where the contracting States have included an umbrella clause,

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[1] *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (hereinafter *SGS v. Pakistan*), ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction of 6 August 2003, 18 ICSID Rev.–F.I.L.J. 307, 2003.

[2] *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (hereinafter *SGS v. Philippines*), ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction of 29 January 2004, available at: ‹http://www.worldbank.org/icsid/cases/SGSvPhil-final.pdf› (last visited on 14 June 2004).

[3] Any references to "contracts" in this article are references to contracts between a State and a foreign investor.

that is, a clause providing that a contracting State shall respect the commitments that it has entered into with nationals of the other contracting State; and

(ii) whether an international arbitration tribunal constituted under an investment treaty will have jurisdiction over a foreign investor's claims for breach of contract where the treaty grants jurisdiction over any disputes relating to a protected investment.

This article argues that the more persuasive reasoning supports the conclusions that:

(i) the very purpose and the effect of an umbrella clause in an investment treaty is to transform breaches of obligations the State has undertaken with respect to the foreign investor and its investment, including contractual obligations, into treaty breaches; and

(ii) when an investment treaty contains a clause providing for a broad grant of jurisdiction over any disputes between a foreign investor and a State relating to a covered investment, a treaty-based tribunal should exercise jurisdiction to decide contractual claims with respect to that covered investment.

The article will also discuss an essential but somewhat overlooked feature common to the two *SGS* Decisions: both Tribunals asserted jurisdiction over the treaty claims regardless of the fact that those claims arose directly out of the underlying contracts. This is a necessary first step in the analysis of the two Decisions. The *SGS* Tribunals, in line with ICSID jurisprudence, acknowledged the existence of independent treaty claims even though those claims arose out of the same set of facts as the contract claims. Having found jurisdiction over the treaty claims, the Tribunals then addressed the issue of jurisdiction over the contract claims. It is on this second step that the Tribunals reached different conclusions.

II. BACKGROUND TO THE *SGS V. PAKISTAN* AND *SGS V. PHILIPPINES* CASES

A. *The Facts in* SGS v. Pakistan

SGS, a Swiss investor, filed a request for arbitration with ICSID on 12 October 2001, claiming that the Government of Pakistan had expropriated its investment in Pakistan in violation of the Switzerland–Pakistan bilateral investment treaty (BIT)[4] and had violated several other provisions of that BIT. These provisions included Pakistan's obligations to accord fair and equitable treatment,[5] to promote and protect SGS' investment[6] and to observe its contractual commitments.[7] SGS also asserted claims against Pakistan for breach of the contract between SGS and the Government of Pakistan.

[4] Agreement between the Swiss Confederation and the Islamic Republic of Pakistan on the Promotion and Reciprocal Protection of Investments, at Article 6(1); signed on 11 July 1995; entered into force on 6 May 1996 (hereinafter, Switzerland–Pakistan BIT).

[5] Ibid., at Article 4(2).

[6] Ibid., at Articles 3(1) and 4(1).

[7] Ibid., at Article 11.

SGS' investment in Pakistan concerned a 1995 contract between SGS and the Government of Pakistan for the provision of pre-shipment inspection services of goods exported to Pakistan from certain countries (PSI Agreement). These services were to be performed abroad and at various ports of entry in Pakistan. The contract included an arbitration clause stating that the parties should first attempt to settle amicably "[a]ny dispute, controversy or claim arising out of, or relating to th[e] Agreement, or breach, termination or invalidity thereof" and then, if that proved unsuccessful, "by arbitration in accordance with the Arbitration Act of the Territory [of Pakistan]" in Islamabad.[8]

After the second year of the PSI Agreement, Pakistan terminated the contract with SGS. In response, SGS brought suit in Swiss courts, arguing that the Government of Pakistan had unlawfully terminated the PSI Agreement. The Swiss courts rejected SGS' claims, ultimately on the ground that Pakistan enjoyed sovereign immunity. During the litigation in Swiss courts, Pakistan invoked the arbitration clause in the PSI Agreement and sought an order from the Pakistani courts to compel arbitration as provided under the contract. SGS objected to the Pakistani arbitration but at the same time filed a counterclaim against the Government of Pakistan for breach of the PSI Agreement. It was at this point that SGS turned to ICSID by filing its request for arbitration under the BIT.

Pakistan then attempted to obtain an injunction in the Pakistani courts against SGS to prohibit it from proceeding with the ICSID arbitration. During these proceedings, Pakistan also requested that the Pakistani courts find SGS in contempt of court for taking steps in furtherance of the ICSID arbitration. Pakistan's Supreme Court granted Pakistan's request for an injunction, thereby purporting to restrain SGS from participating further in the ICSID arbitration, and ordered that domestic arbitration begin. SGS then turned to the ICSID Tribunal for interim measures of protection. The ICSID Tribunal, undeterred by the Pakistani Supreme Court's injunction against SGS moving forward with the ICSID proceedings, recommended, *inter alia*, a stay of the contractual arbitration in Islamabad "until such time, if any, as this Tribunal has issued an award declining jurisdiction over the present dispute, and that award is no longer capable of being interpreted, revised or annulled pursuant to the ICSID Convention".[9]

A jurisdictional hearing was subsequently held on 13 and 14 February 2003,[10] and the Tribunal issued its decision on Pakistan's objections to jurisdiction on 6 August 2003. The Tribunal held, *inter alia*, that it had jurisdiction over SGS' claims for breach of the treaty but not over its claims for breach of the contract.[11]

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[8] *SGS v. Pakistan*, *supra*, footnote 1, at para. 15 (quoting Article 11 of the PSI Agreement).
[9] *SGS v. Pakistan*, Procedural Order No. 2 of 16 October 2002, 18 ICSID Rev.–F.I.L.J. 293, 2003, at 305.
[10] *SGS v. Pakistan*, *supra*, footnote 1, at para. 9.
[11] Ibid., at para. 190.

B. *The Facts in* SGS v. Philippines

The dispute in *SGS v. Philippines* also involved an SGS contract for the provision of pre-shipment inspection services of goods imported from various countries, this time into the Philippines (the CISS Agreement).[12] During the course of the CISS Agreement (March 1992 to March 2000), SGS conducted inspection work for the Philippines valued at approximately US$ 680 million.[13] Of that amount, the Philippines paid approximately US$ 540 million.[14] It was the Philippines' failure to pay the remaining US$ 140 million that was at the heart of the dispute submitted to the ICSID Tribunal by SGS.

SGS filed a request for arbitration with ICSID against the Republic of the Philippines on 26 April 2002. SGS claimed that the Philippines' failure to pay the money owed to SGS constituted a violation of the Switzerland–Philippines BIT,[15] including its provisions for fair and equitable treatment,[16] protection against expropriation[17] and observance of the Philippines' contractual obligations.[18]

The Philippines raised objections to the Tribunal's jurisdiction in November 2002.[19] Both parties made written submissions,[20] and a hearing on jurisdiction was held on 26 and 27 May 2003.[21] The Tribunal issued its decision on the objections to jurisdiction by the Philippines on 29 January 2004. The Tribunal concluded, *inter alia*, that it had jurisdiction over SGS' contract claims under the BIT's dispute settlement provision and gave effect to the BIT's umbrella clause.[22] The Tribunal also asserted jurisdiction over SGS' claims for breach of the BIT's fair and equitable treatment standard.[23] The Tribunal, however, stayed proceedings awaiting a determination of the amount payable by the Philippines to SGS in accordance with the contractual dispute settlement procedures.[24]

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[12] SGS entered into the contract with the Philippines on 23 August 1991, for an initial term of three years. The contract was extended three times and was not terminated until 31 March 2000. *SGS v. Philippines*, *supra*, footnote 2, at paras. 13–14.

[13] Ibid., at para. 35.

[14] Id.

[15] Agreement between the Swiss Confederation and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments; signed on 31 March 1997; entered into force on 23 April 1999 (hereinafter, Switzerland–Philippines BIT).

[16] Ibid., at Article IV(1).

[17] Ibid., at Article VI(1).

[18] Ibid., at Article X(2).

[19] *SGS v. Philippines*, *supra*, footnote 2, at para. 6.

[20] Ibid., at paras. 8–9.

[21] Ibid., at para. 9.

[22] Ibid., at paras. 113–135. After asserting jurisdiction over the contract claims, however, the Tribunal ruled that such claims were inadmissible due to the existence of the forum selection clause in the CISS Agreement; ibid., at paras. 136–155.

[23] Ibid., at paras. 162–163. Additionally, based on the facts presented by SGS, the Tribunal concluded that no case of expropriation existed; ibid., at para. 161.

[24] Ibid., at paras. 163, 169 and 177.

III. Jurisdiction over Treaty Claims arising out of Breach of the Underlying Contract

While the two *SGS* Decisions have often been referred to as contradictory, they have at least one critical component in common: both the *SGS v. Pakistan* and *SGS v. Philippines* Tribunals asserted jurisdiction over SGS' breach of treaty claims. That these treaty claims were related to or arose out of SGS' breach of contract claims did not affect the Tribunals' determination. In the view of both Tribunals, SGS had asserted treaty claims that, as such, were within the Tribunals' jurisdiction.

A. *Contract Breach Giving Rise to Treaty Breach*

There should be no question that a treaty-based arbitration tribunal has jurisdiction over claims asserting breach of the treaty and that the tribunal cannot adopt a different approach merely because the treaty claims arise out of an underlying contract. There are a number of reasons why such a conclusion is not surprising.

First, it is well established under international law that the taking of a foreign investor's contractual rights constitutes expropriation or a measure having an equivalent effect. According to Clagett:

> "Customary international law has long regarded such elementary principles as respect for lawfully acquired property rights and respect for lawfully concluded agreements (*pacta sunt servanda*) as the cornerstones of relations between States and alien investors. It is believed that State liability for breach of these obligations has never been seriously questioned by any twentieth-century arbitral tribunal or other international adjudicatory authority. To the contrary, international tribunals have repeatedly held, in decisions spanning the last hundred years, that under customary international law, when a State takes an alien investor's property, the investor must be compensated."[25]

The Permanent Court of International Justice, in the landmark *Chorzów Factory* case, concluded that Poland's seizure of the factory in Chorzów and its machinery also constituted an expropriation by Poland of the patents and contract rights of the company managing the factory even though the Polish Government had not purported to expropriate the intangible property.[26] Early arbitration decisions followed the same reasoning. For example, in *Company General of the Orinoco*, the French–Venezuelan Mixed Claims Commission determined that the Government of Venezuela owed compensation for its unilateral repudiation of a concession agreement, which was to be "commensurate to the damages caused by the act of the respondent Government [Venezuela] in denying efficacy to the contract".[27] In *Schufeldt*, the Government of

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[25] Brice M. Clagett, *Just Compensation in International Law: The Issues Before the Iran-United States Claims Tribunal*, in Richard B. Lillich (ed.), *The Valuation of Nationalized Property in International Law*, Vol. IV, University of Virginia Press, Charlottesville, Virginia, 1987, 31, at 38.

[26] See *German Interests in Polish Upper Silesia and the Factory at Chorzów* (*Germany v. Poland*) (hereinafter *Chorzów Factory*), Judgment No. 7 of 25 May 1926, 1926 P.C.I.J. 4, Series A, No. 7, at 44.

[27] *Claim of Company General of the Orinoco* (*France v. Venezuela*), Opinion of Umpire of 31 July 1905, Report of French–Venezuelan Mixed Claims Commission of 1902, published 1906, 322, at 362.

Guatemala nullified a concession agreement that it had concluded with a U.S. investor. In considering whether Schufeldt had "acquired any rights of property under the contract" for the purposes of pecuniary indemnification, the Tribunal found that "[t]here can not be any doubt that property rights are created under and by virtue of a contract".[28] ICSID jurisprudence has also followed the same reasoning. In *SPP v. Egypt*, an ICSID Tribunal found that SPP was entitled to compensation for the Egyptian Government's expropriation of its contractual rights. The Tribunal noted that "it has long been recognized that contractual rights may be indirectly expropriated"[29] and that "contract rights are entitled to the protection of international law and that the taking of such rights involves an obligation to make compensation therefore".[30] The Iran–United States Claims Tribunal has also made numerous pronouncements to that effect. In *Phillips v. Iran*, for example, the Tribunal found that:

> "Expropriation ... of the property of an alien gives rise under international law to liability for compensation, and this is so whether the expropriation is formal or *de facto* and whether the property is tangible, such as real estate or a factory, or intangible, such as the contract rights involved in the present Case."[31]

Second, it has been recognized that a State's failure to observe its contractual commitments to a foreign investor may constitute a violation of the international law standard of fair and equitable treatment. According to the European Communities' Investment Protection Principles, the requirement for fair and equitable treatment is an "overriding concept" that encompasses various investment protection principles, including the observance of undertakings.[32] The United Nations Conference on Trade and Development (UNCTAD) also concluded that the fair and equitable treatment standard includes the legal rules of *pacta sunt servanda* and respect for contractual obligations.[33]

Third, contracts are a protected form of investment under most BITs. The overwhelming majority of BITs defines protected investments broadly and explicitly

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[28] *Schufeldt Claim* (*U.S. v. Guatemala*), II Rep. Int'l Arbitral Awards 1081, 1949, at 1097.

[29] *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt* (hereinafter *SPP v. Egypt*), ICSID Case No. ARB/84/3, Award on the Merits of 20 May 1992, 3 ICSID Reports 189, 1995, at para. 165.

[30] Ibid., at para. 164.

[31] *Phillips Petroleum Company Iran v. the Islamic Republic of Iran*, Award 425-39-2 of 29 June 1989, at para. 76. See also *SeaCo, Inc. v. the Islamic Republic of Iran*, Award 531-260-2 of 25 June 1992, at para. 45: "To prevail upon its contention that the Government of Iran expropriated contract rights … SeaCo must show that its contract rights were breached and that the breach resulted from 'orders, directives, recommendations or instructions' of the Government of Iran" (citing *Flexi-Van Leasing, Inc. v. the Government of the Islamic Republic of Iran*, Award No. 259-36-1 of 13 October 1986, at 20); *Starrett Housing Corporation v. the Government of the Islamic Republic of Iran*, ITL Award 32-24-1 of 19 December 1983, at section IV(b).

[32] See, for example, News from ICSID, Vol. 11, No. 1, Winter 1994, at 5 (referring to the Investment Protection Principles adopted in 1992 by the Council of the European Community to provide details for the application of the investment promotion and protection principles contained in the Fourth Lomé Convention on co-operation between the group of Asian, Caribbean and Pacific countries and the EC and its Member States).

[33] See United Nations Conference on Trade and Development, *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements, Geneva, Switzerland, 1999, at 34–37. See also World Bank, *Guidelines on the Treatment of Foreign Direct Investment*, 7 ICSID Rev.–F.I.L.J. 297, Fall 1992, at 300; Article III(2) states that "[e]ach State will extend to investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended in these Guidelines", which include protections regarding expropriation, currency transfers, licences, etc.

includes contractual rights. In both the Switzerland–Pakistan BIT[34] and the Switzerland–Philippines BIT,[35] covered investments include "every kind of assets and particularly ... rights given by law, by contract or by decision of the authority in accordance with the law".

It should not be surprising, therefore, that both *SGS* Tribunals asserted jurisdiction over the treaty claims regardless of the fact that in both cases those claims arose out of contractual disputes. The *SGS v. Pakistan* Tribunal stated that if Article 9 of the Switzerland–Pakistan BIT (the dispute settlement provision) "relates to any dispute at all between an investor and a Contracting Party, it must comprehend disputes constituted by claimed violations of BIT provisions establishing substantive standards".[36] In other words, if the BIT dispute settlement mechanism is to have any meaning, which it obviously must, it must cover disputes where treaty breaches are alleged. The Tribunal concluded: "Any other view would tend to erode significantly those substantive treaty standards of treatment."[37] It is hardly possible to disagree with this conclusion. Moreover, the *SGS v. Pakistan* Tribunal did not see why it should revise its conclusion simply because the treaty claims arose out of the same set of facts as the breach of contract claims. It noted that "[a]s a matter of general principle, the same set of facts can give rise to different claims grounded on differing legal orders: the municipal and the international legal orders", quoting extensively from the Decision of the Annulment Committee in *Vivendi*.[38]

The *SGS v. Philippines* Tribunal followed the same logic. It noted that a treaty-based tribunal should assert jurisdiction where the claims presented involve "allegations which, if proved, [are] capable of amounting to breaches" of the relevant BIT.[39] The Tribunal also quoted from the Annulment Decision in *Vivendi*, where the Annulment Committee stated:

> "[T]he conduct alleged by Claimants, if established, *could* have breached the BIT. The claim was not simply reducible to so many civil or administrative law claims concerning so many individual acts alleged to violate the Concession Contract ... It was open to Claimants to claim, and they did claim, that these acts taken together, or some of them, amounted to a breach of Articles 3 and/or 5 of the BIT." (emphasis in original).[40]

The *SGS v. Philippines* Tribunal, like the *SGS v. Pakistan* Tribunal, went on to find that where the investor asserted claims for breaches of the BIT's substantive protections—even where those claims of treaty breach arose out of contractual disputes—the tribunal has jurisdiction.[41]

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[34] Switzerland–Pakistan BIT, *supra*, footnote 4, at Article 1(2)(e).
[35] Switzerland–Philippines BIT, *supra*, footnote 15, at Article 1(2)(e).
[36] *SGS v. Pakistan*, *supra*, footnote 1, at para. 150.
[37] Id.
[38] Ibid., at para. 147.
[39] *SGS v. Philippines*, *supra*, footnote 2, at para. 158.
[40] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (hereinafter *Vivendi*), ICSID Case No. ARB/97/3, Decision on Annulment of 3 July 2002, 41 I.L.M. 1135, 2002, at para. 112.
[41] *SGS v. Philippines*, *supra*, footnote 2, at paras. 162–163 and 177. The Tribunal found that exercising that jurisdiction was premature for other reasons and suspended proceedings; see ibid., at paras. 163 and 177.

It may well be that a treaty-based tribunal called upon to decide on claims for treaty breaches arising out of a contractual relationship will first have to determine whether or not the underlying contract has been breached. This may require the tribunal to engage in a detailed and elaborate review of the contract and the rights and obligations arising from it. As the Annulment Committee in *Vivendi* noted, if the tribunal is called to decide on treaty claims arising out of contractual breaches, it cannot abdicate its responsibility and refuse to rule simply because detailed contractual analysis may be required. The Annulment Committee criticized the *Vivendi* Tribunal because "the Tribunal declined to decide key aspects of the Claimants' BIT claims on the ground that they involved issues of contractual performance or non-performance"[42] and annulled that portion of the *Vivendi* Award. The Annulment Committee's conclusion is consistent with the long-established practice of international tribunals of interpreting contracts and national law when necessary to determine whether there has been a breach of international law.[43]

B. *Jurisdiction over Treaty Claims arising out of Contractual Disputes and Forum Selection Clauses in the Underlying Contracts*

The *SGS v. Pakistan* Tribunal decided to assert jurisdiction over SGS' claims for breach of the treaty notwithstanding a forum selection clause in the underlying contract, the PSI Agreement, in favor of arbitration in Pakistan under Pakistan's Arbitration Act. The Tribunal again quoted extensively from the *Vivendi* Annulment Decision, where the Annulment Committee stated:

> "[W]here the 'fundamental basis of the claim' is a treaty laying down an independent standard by which the conduct of the parties is to be judged, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state ... cannot operate as a bar to the application of the treaty standard. At most, it might be relevant—as municipal law will often be relevant—in assessing whether there has been a breach of the treaty."[44]

Following the same reasoning, the *SGS v. Pakistan* Tribunal rejected Pakistan's objection that the contractual arbitration clause trumped Pakistan's consent to ICSID arbitration under the BIT and that, therefore, the ICSID Tribunal was required to defer to the parties' contractual agreement to submit disputes to an alternative forum.

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[42] *Vivendi*, Decision on Annulment, *supra*, footnote 40, at para. 108.

[43] For example, even though Article 38(1) of the Statute of the International Court of Justice explicitly states that the Court's function is to decide in accordance with international law, the Court has concluded that it must address questions of domestic law and contract interpretation when necessary to resolve a question of international law. See, for example, *German Settlers in Poland*, Advisory Opinion of 10 September 1923, 1923 P.C.I.J. 6, Series B, No. 6; *The Mavrommatis Jerusalem Concessions* (*Greece v. United Kingdom*), Judgment of 26 March 1925, 1925 P.C.I.J. 6, Series A, No. 5; *Chorzów Factory*, *supra*, footnote 26; *Serbian Loans Case* (*France v. Serbia*), Judgment No. 14 of 12 July 1929, 1929 P.C.I.J. 5, Series A, Nos. 21 and 22; *Payment in Gold of Brazilian Federal Loans Issued in France* (*France v. Brazil*), Judgment No. 15 of 12 July 1929, 1929 P.C.I.J. 93, Series A, Nos. 21 and 22; *Consistency of Certain Danzig Legislative Decrees with the Constitution of the Free City*, Advisory Opinion of 4 December 1935, 1935 P.C.I.J. 41, Series A/B, No. 65; *The Panevezys-Saldutiskis Railway Case* (*Estonia v. Lithuania*), Judgment of 28 February 1939, 1939 P.C.I.J. 4, Series A/B, No. 76. See also C. Wilfred Jenks, *The Prospects of International Adjudication*, Oceana Publications, Dobbs Ferry, New York, 1964, at 572–573 (discussing international claims where contracts under domestic law were at issue).

[44] *Vivendi*, Decision on Annulment, *supra*, footnote 40, at para. 101 (internal citation omitted).

Indeed, the *SGS v. Pakistan* Tribunal went even further. It asserted jurisdiction despite the existence not only of a contractual forum selection clause but also of ongoing parallel proceedings in Pakistan under the PSI Agreement. The Tribunal held that its jurisdiction would not "to any degree be shared by the PSI Agreement arbitrator".[45] The Tribunal also noted that its jurisdiction was not dependent upon "the findings of the PSI Agreement arbitrator", that the Tribunal was required to "consider all facts relevant to determination of the BIT causes of action, including facts relating to the terms of the PSI Agreement"[46] and that it was "bound to exercise its jurisdiction and proceed to consider the BIT claims".[47]

Moreover, in addition to parallel proceedings under the contractual dispute settlement mechanism in Pakistan, the *SGS v. Pakistan* Tribunal faced an injunction issued by Pakistani courts against the continuation of the ICSID proceedings and—quite remarkably—the prospect of contempt proceedings in Pakistan in case of non-compliance with the injunction. The Tribunal disposed of those "hurdles" in a procedural order. It recommended that Pakistan take no steps to initiate a complaint for contempt and that, if initiated, such proceedings "not be acted upon" because "this Tribunal must discharge its duty to determine whether it has the jurisdiction to consider the international claim on the merits".[48] It further recommended that the arbitration under the PSI Agreement in Pakistan be stayed.[49]

In the *SGS v. Philippines* case, there was also a forum selection clause in the CISS Agreement referring disputes to the local courts of the Philippines.[50] The *SGS v. Philippines* Tribunal, like the *SGS v. Pakistan* Tribunal, remained undeterred by the existence of the forum selection clause when it exercised jurisdiction over SGS' claims for breach of the BIT's fair and equitable treatment requirement and the BIT's umbrella clause.[51]

The *SGS* Tribunals' holdings are in line with prior ICSID jurisprudence that has similarly found that contractual forum selection clauses do not prevent ICSID tribunals from asserting jurisdiction over treaty claims.[52] In *Lanco v. Argentina*, the underlying concession agreement included a forum selection clause in favor of the domestic courts

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[45] *SGS v. Pakistan*, *supra*, footnote 1, at para. 155.

[46] Ibid., at para. 186.

[47] Ibid., at para. 187.

[48] *SGS v. Pakistan*, Procedural Order No. 2, *supra*, footnote 9. See also Emmanuel Gaillard, *Jurisprudence—Centre international pour le règlement des différends relatifs aux investissements (CIRDI)*, 131 Journal de Droit International 257, 2004, at 271–272 (characterizing the *SGS v. Pakistan* Tribunal's response to Pakistan's anti-suit injunction as an "anti-anti-suit injunction").

[49] *SGS v. Pakistan*, Procedural Order No. 2, ibid.

[50] *SGS v. Philippines*, *supra*, footnote 2, at para. 22.

[51] Ibid., at paras. 162–163 and 177. Unfortunately, the logic of the Tribunal's ruling is somewhat weakened by its finding, cast in the rubric of admissibility, that SGS' treaty claims are "premature and must await the determination of the amount payable in accordance with the contractually-agreed process" (at para. 163), even though this finding did not affect its holding on jurisdiction: while asserting jurisdiction, the Tribunal decided to stay proceedings (at para. 177(c)). This part of the Decision of the Tribunal was adopted by majority, with Professor Antonio Crivellaro attaching a Declaration stating his disagreement.

[52] See generally *Lanco International Inc. v. the Argentine Republic* (hereinafter *Lanco*), ICSID Case No. ARB/97/6, Preliminary Decision: Jurisdiction of the Arbitral Tribunal, 8 December 1998, 40 I.L.M. 457, 2001; *Vivendi*, Award of 21 November 2000, 40 I.L.M. 426, 2001; *Vivendi*, Decision on Annulment, *supra*, footnote 40.

of Argentina. Argentina argued that the ICSID Tribunal did not have jurisdiction over the treaty claims arising out of the concession because the contractual forum selection clause prevailed over Argentina's more general consent to ICSID arbitration in the BIT. The *Lanco* Tribunal, however, rejected Argentina's argument, finding instead that the United States–Argentina BIT "allows the investor to submit the dispute to ICSID arbitration" and "therefore gives the investor the power to choose among several methods of dispute settlement; consequently, once the investor has expressed its consent in choosing ICSID arbitration, the only means of dispute settlement available is ICSID arbitration".[53]

The ICSID Tribunal in the *Vivendi* case also recognized that the existence of a forum selection clause in an underlying contract does not strip an ICSID tribunal of jurisdiction over treaty claims, including treaty claims arising out of the contract. The Tribunal held that the forum selection clause in the concession contract at issue did not "divest th[e] Tribunal of jurisdiction to hear th[e] case because that provision did not and could not constitute a waiver by CGE [the investor] of its rights" under the treaty.[54] In other words, the forum selection clause could not be "deemed to prevent the investor from proceeding under the ICSID Convention against the Argentine Republic on a claim charging the Argentine Republic with a violation of the Argentine–French BIT".[55] The Annulment Committee in the *Vivendi* case affirmed the Tribunal's holding on this issue. According to the Annulment Committee, notwithstanding the contractual forum selection clause, "it is nonetheless the case that the conduct alleged by Claimants, if established, *could* have breached the BIT" (emphasis in original).[56] Therefore, the ICSID Tribunal was obligated to exercise jurisdiction over such BIT claims.

In sum, in line with ICSID jurisprudence, both *SGS* Tribunals issued consistent rulings on a critical point: once treaty claims are asserted, treaty-based tribunals are bound to decide on those claims (provided all other jurisdictional requirements are met) and cannot abdicate this responsibility on the grounds that the treaty claims are intertwined or inextricably linked with contract claims. Neither contractual forum selection clauses nor parallel proceedings in domestic courts or arbitration under such clauses can bar a treaty-based tribunal from discharging its responsibility to decide on claims for breaches of the treaty.

IV. The Effect of Umbrella Clauses in Investment Treaties

Jurisprudence and authorities support the proposition that a breach of contract by a State may well be, and often is, a breach of an investment treaty obligation. States incur international responsibility when they violate a contract in a manner that constitutes a "clear and discriminatory departure" from the governing law of the contract or an

[53] *Lanco*, ibid., at para. 31.
[54] *Vivendi*, Award, *supra*, footnote 52, at para. 53.
[55] Ibid., at para. 54.
[56] *Vivendi*, Decision on Annulment, *supra*, footnote 40, at para. 112.

"unreasonable departure from the principles recognized by the principal legal systems of the world".[57] States are internationally responsible when they untimely terminate a contract[58] and when a termination is effected "by the exercise of sovereign power instead of claimed contractual right".[59]

Notably, States are also responsible under international law for contractual breaches when they have frustrated the contractual dispute settlement mechanism, leaving the foreign investor with no recourse to contractual remedies to redress a contractual wrong. Both the *SGS v. Pakistan* Tribunal and the *SGS v. Philippines* Tribunal agreed that there would be a viable treaty breach claim if the investor were prevented from submitting disputes to the contractual dispute settlement mechanism.[60] The very recent decision in the *Waste Management* case also recognized that the availability and the viability of a contractual dispute settlement mechanism was critical to determining whether certain acts violated substantive provisions of the treaty.[61]

Under this prevailing view, some (perhaps many) types of contractual breaches by the State would trigger the State's responsibility under customary international law and amount to a breach of an investment treaty. Apart from the types of contractual breaches mentioned above, where the line is to be drawn between contractual breaches that do not rise to the level of treaty violations and those that do is determined on the facts of a specific case. There is also a view that every breach by the State of a contract with an alien invokes the State's international responsibility.[62]

Against this background, it should hardly come as a surprise that States may wish to agree in an investment treaty to consider all contractual breaches, or breaches of other obligations undertaken by the State with respect to foreign investors, as treaty breaches. Typically, they do so in the form of an "umbrella clause" or an "observance of undertakings clause" providing that the host State must observe any commitments that

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[57] Louis B. Sohn and R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 Am. J. Int'l L. 545, 1961, at Article 12(1). See also Marjorie M. Whiteman, *Damages in International Law*, Vol. III, United States Government Printing Office, Washington, D.C., 1943, at 1558; K. Lipstein, *The Place of the Calvo Clause in International Law*, 22 Brit. Y.B. Int'l L. 130, 1945, at 134; F.A. Mann, *The Proper Law of Contracts Concluded by International Persons*, 35 Brit. Y.B. Int'l L. 34, 1959, at 41.

[58] See, for example, *In the Matter of an Arbitration between the Government of the State of Kuwait and the American Independent Oil Co.* (hereinafter *Aminoil*), Final Award of 24 March 1982, 21 I.L.M. 976, 1982, at 1051 (dissenting opinion of Sir G. Fitzmaurice).

[59] Kenneth S. Carlston, *Concession Agreements and Nationalization*, 52 Am. J. Int'l L. 260, 1958, at 261.

[60] See *SGS v. Pakistan*, *supra*, footnote 1, at para. 172; *SGS v. Philippines, supra*, footnote 2, at paras. 154, 155 and 170.

[61] *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, available at: ‹http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf› (last visited on 14 June 2004). The *Waste Management* Tribunal found that a contractual claim was not a violation of Article 1105 of the North American Free Trade Agreement (NAFTA), "provided that it does not amount to an outright and unjustified repudiation of the transaction and *provided that some remedy is open to the creditor to address the problem*" (at para. 115; emphasis added). It also found that the contractual claim was not a violation of Article 1110 of the NAFTA because such a violation required a showing of "an effective repudiation of the [contractual] right, *unredressed by any remedies available to the Claimant*, which has the effect of preventing its exercise entirely or to a substantial extent" (at para. 175; emphasis added).

[62] For authorities supporting this "maximalist approach", see Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, 128 Recueil des Cours 95, 1969, at 134–137.

it has undertaken with respect to the foreign investor. Thus, an umbrella clause in a treaty intends to achieve more than what is already the norm under customary international law.

A. *Treaty Clauses Equating Contract Breaches and Treaty Breaches*

The origin of the principle embodied in an umbrella clause can be found in the Organisation for Economic Co-operation and Development's (OECD) Draft Convention on the Protection of Foreign Property (OECD Draft).[63] Article 2 (titled "Observance of Undertakings") of the OECD Draft provides that "[e]ach Party shall at all times ensure the observance of undertakings given by it in relation to property of nationals of any other Party".[64] The accompanying notes and comments elaborate on the meaning and purpose of the clause: "Article 2 represents an application of the general principle of *pacta sunt servanda*—the maintenance of the pledged word" and "applies to agreements between States and foreign nationals."[65] The notes and comments state further that "any right originating under such an undertaking gives rise to an *international* right" (emphasis in the original) and that "[t]he validity of this principle has not been challenged".[66] They also provide that the object of the protection in the umbrella clause—the "property"—is to be interpreted in the widest sense of the term and includes, but is in no way limited to, investments[67] and that "[a]n undertaking may be embodied in a contract or in a concession".[68] As seems clear from the notes and comments, the drafters believed that a breach by a State of a contract with an alien involves a breach of international law in its own right but decided to include Article 2 for extra security, to ensure that a foreign investor's contractual rights would be protected by transforming those rights into rights under international law.

The purpose and the effect of the umbrella clause are explained by Weil. In discussing whether a breach by a State of a contract with an alien is a violation of international law, Weil concludes that a breach of contract claim is elevated to a treaty claim when a treaty provision "transforms" a contract claim into a treaty claim[69] and points out that the "observance of undertakings" provision in the OECD Draft achieves precisely such a transformation.[70] According to Weil:

> "There is, in fact, no particular difficulty when there is an 'umbrella treaty' between the contracting State and the State of the other contracting party, which turns the obligation to perform the contract into an international obligation of the contracting State *vis-à-vis* the State of the other contracting party. The intervention of the umbrella treaty transforms the

[63] OECD, Draft Convention on the Protection of Foreign Property, 1962 Draft, 2 I.L.M. 241, 1963; 1967 Draft, 7 I.L.M. 117, 1968.
[64] Ibid., 2 I.L.M., 1963, at 247; and 7 I.L.M., 1968, at 123.
[65] Ibid., 2 I.L.M., 1963, at 247, note 1; and 7 I.L.M., 1968, at 123, note 1(a).
[66] Ibid., 2 I.L.M., 1963, at 247, note 1; and 7 I.L.M., 1968, at 123, note 1(b) (internal citation omitted).
[67] Ibid., 2 I.L.M., 1963, at 247, note 2; and 7 I.L.M., 1968, at 123, note 2.
[68] Ibid., 2 I.L.M., 1963, at 247, note 3(a); and 7 I.L.M., 1968, at 123, note 3(a).
[69] Weil, *supra*, footnote 62, at 130.
[70] Ibid., at 132.

> contractual obligations into international obligations thereby ensuring, as it has already been stated, 'the inviolability of the contract under threat of violating the treaty'; any non-performance of the contract, even if it is legal under the national law of the contracting State, gives rise to the international liability of the latter *vis-à-vis* the State of the other contracting party."[71]

This is a notion that is not at all alien to customary international law, as evidenced in *Oppenheim's International Law*:

> "[E]ither by virtue of a term in the contract itself or of an agreement between the state and the alien, or by virtue of an agreement between the state allegedly in breach of its contractual obligations and the state of which the alien is a national, disputes as to compliance with the terms of contracts may be referred to an internationally composed tribunal, applying, at least in part, international law."[72]

Ample authorities support the view that the intent of States, when negotiating and including an umbrella clause in their investment treaties, was precisely that: to elevate the State's contractual breaches to the level of treaty violations. The UNCTAD study *Bilateral Investment Treaties in the Mid-1990s* notes that the typical umbrella clause in BITs:

> "… is directed in particular at investment agreements that host countries frequently conclude with individual foreign investors ... Indeed, 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."[73]

The study then finds that the existence of such a clause in a BIT means that "violations of commitments regarding investment by the host country would be redressible through the dispute-settlement procedures of a BIT".[74] Thus, in other words, by operation of the umbrella clause, a breach of a contract by the State is deemed to constitute a violation of the BIT that could be redressed under the dispute settlement provisions of the BIT. The United Nations Centre on Transnational Corporations similarly has concluded that the presence of an umbrella clause in a BIT:

> "… makes the respect of such contracts [between the host State and the investor] … an obligation under the treaty. Thus, the breach of such a contract by the host State would engage its responsibility under the agreement and—unless direct dispute settlement procedures come into play—entitle the home State to exercise diplomatic protection of the investor."[75]

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[71] Ibid., at 130 (author's translation from the French original).

[72] Robert Jennings and Arthur Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I, Longman's, London, 1992, at 927 (internal citation omitted).

[73] UNCTAD, *Bilateral Investment Treaties in the Mid-1990s*, Geneva, Switzerland, 1998, at 56 (internal citation omitted). The authors cite as a typical example the umbrella clause in the Denmark–Lithuania BIT, which provides that "[e]ach Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party" (internal citation omitted).

[74] Id. It is interesting to note that the authors go even further, concluding that the provision of an umbrella clause in a BIT "might possibly alter the [domestic] legal regime [to which an investment agreement between a host country and a foreign investor is subject] and make the agreement subject to the rules of international law". However, this proposition is beyond the scope of this article and will not be addressed here.

[75] United Nations Centre on Transnational Corporations, *Bilateral Investment Treaties*, UNCTC, 1988, at 39.

The views of learned commentators also support the conclusion that umbrella clauses "transform" contract claims into treaty claims or elevate claims for breaches of contract into claims for breaches of the treaty and that this is precisely what the States intend when they include such clauses in their treaties. Schreuer, a leading authority on investment treaty arbitration jurisprudence, states:

> "[Umbrella clauses] have been added to some BITs to provide additional protection to investors beyond the traditional international standards. They are often referred to as umbrella clauses because they put contractual commitments under the BIT's protective umbrella. They add the compliance with investment contracts, or other undertakings of the host State, to the BIT's substantive standards. In this way, a violation of such a contract becomes a violation of the BIT."[76]

Former ICSID Secretary-General Ibrahim Shihata, citing Weil, also recognized that "treaties may furthermore elevate contractual undertakings into international law obligations, by stipulating that breach by one State of a contract with a private party from the other State will also constitute a breach of the treaty between the two States".[77] In Dolzer and Stevens's work, *Bilateral Investment Treaties*, the authors find that umbrella clauses:

> "… seek to ensure that each Party to the treaty will respect specific undertakings towards nationals of the other Party. The provision is of particular importance because it protects the investor's contractual rights against any interference which might be caused by either a simple breach of contract or by administrative or legislative acts, and because it is not entirely clear under general international law whether such measures constitute breaches of an international obligation."[78]

They go on to note that it is "generally assumed" that commitments "arising from investment contracts, i.e. contracts between a Party and investors from the other Contracting Party", are included under the scope of the umbrella clause.[79]

Authorities reviewing the BIT practices of specific States arrive at the same conclusion. Article 8(2) of Germany's 1991 Model BIT provides: "Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party."[80] Karl, in an analysis of this Model BIT, states that this clause "relates particularly to investment contracts between the investor and the host country" and that "[t]he protection of such contracts is now a standard clause in bilateral investment agreements".[81] He notes that some

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[76] Christoph Schreuer, *Travelling the BIT Route—Of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 J.W.I.T. 2, April 2004, at 250.

[77] Ibrahim F.I. Shihata, *Applicable Law in International Arbitration: Specific Aspects in Case of the Involvement of State Parties*, in I.F.I. Shihata and J.D. Wolfensohn (eds.), *The World Bank in a Changing World: Selected Essays and Lectures*, Vol. II, Brill Academic Publishers, Leiden, Netherlands, 1995, at 601.

[78] Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties*, Kluwer Law International, The Hague, 1995, at 81–82 (internal citation omitted).

[79] Ibid., at 82.

[80] 1991 German Model Treaty on the Encouragement and Reciprocal Protection of Investments (February 1991), 11 ICSID Rev.–F.I.L.J. 221, No. 1, Spring 1996, at 226.

[81] Joachim Karl, *The Promotion and Protection of German Foreign Investment Abroad*, 11 ICSID Rev.–F.I.L.J. 1, No. 1, Spring 1996, at 23 (internal citation omitted).

countries are "reluctant to accept this provision which transforms responsibility incurred towards a private investor under a contract into international responsibility".[82]

The intent of the umbrella clause in the 1992 U.S. Model BIT is also to protect the investor against even a simple breach of contract, and the clause makes it clear that such a breach of contract is a breach of an international obligation.[83] This is also true of U.S. investment treaties that do not follow the BIT model. Article II.6 of the Business and Economic Relations Treaty between the United States and Poland requires, *inter alia*, that "[e]ach Party shall observe any obligation it may have entered into with regard to investments".[84] Leich, commenting on the key provisions of that treaty, finds that this clause includes a State's obligation to observe its contractual commitments. The Contracting Parties are, therefore, "obliged to observe their contractual obligations with regard to investments and commercial activities".[85]

In his discussion of British BITs, Mann describes the umbrella clause as a:

> "… provision of particular importance in that it protects the investor against any interference with his contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of the question whether or no[t] such interference amounts to expropriation."[86]

According to Mann, the umbrella clause covers obligations resulting from a particular commitment made by a host State to a foreign investor, including those obligations arising from a "contract with the State".[87]

B. *The Reasoning and Conclusions of the* SGS *Tribunals*

In light of these overwhelming authorities, it is surprising that the Tribunal in *SGS v. Pakistan* refused to give effect to the umbrella clause in the Switzerland–Pakistan BIT. It is, on the other hand, quite logical that the Tribunal in *SGS v. Philippines* expressly disagreed with the *SGS v. Pakistan* Tribunal and gave effect to the umbrella clause in the Switzerland–Philippines BIT.

The question before both *SGS* Tribunals was whether the umbrella clauses in the respective BITs imposed substantive treaty obligations on the State Parties to observe their contractual commitments to foreign investors. The *SGS v. Pakistan* Tribunal was

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[82] Ibid. At the same time, Karl points out that this reluctance is pointless, as the protection afforded in such a clause also exists under the Model BIT's provision for fair and equitable treatment of the investments of a foreign investor.

[83] See Dolzer and Stevens, *supra*, footnote 78, at 81–82.

[84] Treaty between the United States of America and the Republic of Poland Concerning Business and Economic Relations; signed on 21 March 1990; entered into force on 6 August 1994; available at: ‹http://www.tcc.mac.doc.gov/cgi-bin/doit.cgi?204:64:286550797:202› (last visited on 14 June 2004).

[85] Marian Nash Leich, *Contemporary Practice of the United States Relating to International Law*, 84 Am. J. Int'l L. 885, 1990, at 898.

[86] F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 Brit. Y.B. Int'l L. 241, 1982, at 246.

[87] Id.

confronted with an umbrella clause in Article 11 of the Switzerland–Pakistan BIT which provided: "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."[88] The Tribunal found that the umbrella clause in Article 11 did not transform SGS' claims against the Government of Pakistan for breach of contract into claims for breach of the BIT. It admitted that the ordinary meaning of the text of the umbrella clause, in compliance with the rule of interpretation in Article 31 of the Vienna Convention on the Law of Treaties, would in fact transform Pakistan's contract breaches into treaty breaches. It was concerned, however, that such an interpretation would broaden the scope of the provision beyond what the contracting States intended and, apparently, beyond what the Tribunal was willing to accept. That policy concern was permitted to trump the text of the BIT.

The Tribunal was concerned that "[a]s a matter of textuality ... the scope of Article 11 of the BIT ... appears susceptible of almost indefinite expansion"[89] and that the consequences of such interpretation 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" that the ordinary meaning of the text should be ignored unless "[c]lear and convincing evidence that such was indeed the shared intent of the Contracting Parties" to the BIT could be adduced.[90] Thus, despite the Tribunal's acknowledgment that the ordinary meaning of the text of Article 11 would confer jurisdiction, it determined instead that Article 11 "would have to be considerably more specifically worded before it can reasonably be read in the extraordinarily expansive manner submitted by the Claimant [SGS]".[91] The Tribunal feared that the umbrella clause, if interpreted according to its ordinary meaning, would "internationalize" contracts into international agreements subject to international law.[92] Recognizing that its ruling would deprive the umbrella clause of any meaning, it struggled to give it some different meaning but was not able to do so persuasively.[93]

This holding of the *SGS v. Pakistan* Tribunal was promptly criticized by the Government of Switzerland, a State Party to the BIT in question in that case. In a letter to ICSID's Deputy-Secretary General dated 1 October 2003, the Swiss Government stated that it was:

> "… alarmed about the very narrow interpretation given to the meaning of Article 11 by the [ICSID] Tribunal, which not only runs counter to the intention of Switzerland when concluding the Treaty but is quite evidently neither supported by the meaning of similar

[88] *SGS v. Pakistan*, *supra*, footnote 1, at para. 163 (citing Article 11 of the Switzerland–Pakistan BIT, *supra*, footnote 4).
[89] Ibid., at para. 166.
[90] Ibid., at para. 167.
[91] Ibid., at para. 171 (internal citation omitted).
[92] See ibid., at para. 172.
[93] See id. For an analysis of the *SGS v. Pakistan* Tribunal's reasoning with respect to the umbrella clause, see Gaillard, *supra*, footnote 48, at 273–275. (Gaillard was lead counsel for SGS in the case.)

> articles in BITs concluded by other countries nor by academic comments on such provisions."[94]

Thus, according to the Government of Switzerland, the State Parties to the Switzerland-Pakistan BIT did indeed intend to include "contractual" commitments among those commitments that were meant to be protected under Article 11 of the BIT.

The *SGS v. Philippines* Tribunal took issue with the holding of the *SGS v. Pakistan* Tribunal on the meaning and effect of the umbrella clause and criticized it expressly and rather pointedly. In *SGS v. Philippines*, the Tribunal was faced with an umbrella clause in Article X(2) of the Switzerland–Philippines BIT that read: "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."[95] The Tribunal concluded that the umbrella clause at issue referred to contractual obligations assumed by the Government of the Philippines and, therefore, elevated SGS' contract breach claims into treaty breach claims. According to the Tribunal, the umbrella clause "makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments".[96] In reaching this conclusion, the Tribunal found:

> "The term 'any obligation' is capable of applying to obligations arising under national law, e.g. those arising from a contract; indeed it would normally be under its own law that a host State would assume obligations 'with regard to specific investments in its territory by investors of the other Contracting Party'. Interpreting the actual text of Article X(2), it would appear to say, and to say clearly, that each Contracting Party shall observe any legal obligation it has assumed, or will in the future assume, with regard to specific investments covered by the BIT."[97]

In the view of the Tribunal, that interpretation was consistent with the intent of the contracting States and the object and purpose of the BIT, which is to promote and protect investments.[98]

Acknowledging that the *SGS v. Pakistan* Tribunal had reached the opposite conclusion, the Tribunal in *SGS v. Philippines* dismissed the *SGS v. Pakistan* Tribunal's reasons as "unconvincing".[99] It criticized the *SGS v. Pakistan* Tribunal for failing to interpret the umbrella clause according to its ordinary meaning and for failing to give it "any clear meaning".[100] Further, the *SGS v. Philippines* Tribunal addressed the *SGS v. Pakistan* Tribunal's concern that the scope of the umbrella clause, interpreted textually,

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[94] Interpretation of Article 11 of the Bilateral Investment Treaty between Switzerland and Pakistan in the light of the Decision of the Tribunal on Objections to Jurisdiction of ICSID in Case No. ARB/01/13 *SGS Société Générale de Surveillance S.A. versus Islamic Republic of Pakistan* (Section E 05-040227-111X), attached to *ICSID Tribunal's Interpretation of BIT Article 11 Worries Swiss*, 19-2 Mealey's Int'l Arb. Rep. 1, 2004.

[95] *SGS v. Philippines*, *supra*, footnote 2, at para. 115 (citing Article X(2) of the Switzerland–Philippines BIT, *supra*, footnote 15).

[96] Ibid., at para. 128.

[97] Ibid., at para. 115 (internal citation omitted).

[98] Ibid., at para. 116.

[99] Ibid., at para. 125.

[100] Id.

would be excessively broad. It noted that the umbrella clause covered specific binding legal obligations assumed *vis-à-vis* a specific investment.[101] It then pointed out that, while the majority view may be that a State's breach of contract is not *per se* a breach of international law, "a clause in a treaty requiring a State to observe specific domestic commitments has effect in international law" and nothing prevents States from agreeing to include such a clause in their BITs.[102]

Finally, the *SGS v. Philippines* Tribunal noted that the umbrella clause does not "internationalize" investment contracts by instantly turning them into treaties, as the *SGS v. Pakistan* Tribunal was concerned it would do. An umbrella clause, the *SGS v. Philippines* Tribunal stated: "... does not convert questions of contract law into questions of treaty law. In particular it does not change the proper law of the CISS Agreement from the law of the Philippines to international law."[103] Rather, an umbrella clause "addresses not the *scope* of the commitments entered into with regard to specific investments but the *performance* of these obligations, once they are ascertained" (emphasis in original).[104] In other words, a breach of contract would be determined by the treaty-based tribunal on the basis of the applicable domestic law. Once such a breach were found, the State would be internationally responsible for a breach of its treaty obligation to observe contractual commitments. Therefore, the general principle, as articulated by the Annulment Committee in the *Vivendi* case, still holds true:

> "[W]hether there has been a breach of the BIT and whether there has been a breach of contract are different questions. *Each of these claims will be determined by reference to its own proper or applicable law*—in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract …" (emphasis added).[105]

In giving the umbrella clause its proper interpretation and effect, the *SGS v. Philippines* Tribunal dealt persuasively with the policy concerns expressed by the *SGS v. Pakistan* Tribunal. The *SGS v. Pakistan* Tribunal ignored the ample authorities interpreting the umbrella clause for what it is: a substantive treaty obligation requiring States to observe contractual and other commitments entered into with foreign investors. It is fortunate that the Decision in *SGS v. Philippines* was rendered only within six months of the Decision in *SGS v. Pakistan*. Otherwise, the *SGS v. Pakistan* Decision would have remained the only interpretation of the umbrella clause by an ICSID tribunal to date.

V. JURISDICTION OVER BREACHES OF CONTRACT NOT BASED ON UMBRELLA CLAUSES

In both *SGS* cases, the ICSID Tribunals were also faced with the question of whether or not they had jurisdiction, under the respective BITs, over SGS' claims based only on breach of contract. This question is separate and independent from the question as to

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[101] Ibid., at para. 121.
[102] Ibid., at para. 122.
[103] Ibid., at para. 126.
[104] Id. (internal citation omitted).
[105] *Vivendi*, Decision on Annulment, *supra*, footnote 40, at para. 96.

whether a State's alleged contract breaches rise to the level of treaty breaches because of their nature or because they are "elevated" to that level by an umbrella clause. The question here is whether a treaty-based tribunal has jurisdiction to decide claims for breach of contract as such where the respective BIT dispute settlement clause grants jurisdiction over a broad category of investment disputes not limited to disputes relating to substantive treaty protections.

The jurisdictional clauses in BITs vary in scope. At one end of the spectrum is a narrow jurisdictional clause that provides only for the settlement of disputes relating to obligations under the BIT—in other words, disputes based on claims for breach of the treaty.[106] At the other end of the spectrum would be a quite broad grant of jurisdiction that takes the form of a clause providing for the settlement of "*[a]ny disputes* arising between a Contracting Party and the investors of the other" (emphasis added).[107] The jurisdictional clauses in the Switzerland–Pakistan and Switzerland–Philippines BITs, which provide for the settlement of "disputes with respect to investments between a Contracting Party and an investor of the other Contracting Party",[108] are at the latter end of the spectrum.

It would appear that the ordinary meaning of the text should leave no doubt that "disputes with respect to investments" would include disputes between the investor and the host State relating to a breach of an investment contract by the latter. Article 31(1) of the Vienna Convention on the Law of Treaties provides 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".[109] A "dispute" may be defined as "the act of disputing or arguing against something or someone; controversy, debate".[110] There is no reference in the BIT to the subject-matter of the dispute other than that it has to be "with respect to investments". No distinction is made between disputes arising from breaches of contract with respect to investments as compared to disputes arising from breaches of the BIT with respect to investments. Thus, from the ordinary meaning of "any disputes" and "disputes with respect to investments", it seems evident that disputes arising from contract breaches fall under these clauses.

In the case of both the Switzerland–Pakistan and the Switzerland–Philippines BITs, therefore, a foreign investor's claims for breach of contract as such should fall under the

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[106] See, for example, Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments; signed on 18 March 1998; entered into force on 29 September 1999. Article XII(1) provides for the settlement of "[a]ny dispute between one Contracting Party and an investor of the other Contracting Party, relating to a claim by the investor that a measure taken or not taken by the former Contracting Party is in breach of this Agreement …"

[107] See, for example, Agreement between the Government of the Italian Republic and the Government of the Islamic Republic of Pakistan on the Promotion and Protection of Investments; signed on 19 July 1997; entered into force on 22 June 2001; at Article 9(1).

[108] Switzerland–Pakistan BIT, *supra*, footnote 4, at Article 9(1); Switzerland–Philippines BIT, *supra*, footnote 15, at Article VIII(1).

[109] Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331, 1980, at Article 31(1).

[110] *The New Shorter Oxford English Dictionary*, Vol. I, Oxford University Press, Oxford, U.K., 1993, p. 701.

clause providing for the settlement of "disputes with respect to investments". However, the *SGS* Tribunals, operating under identically worded jurisdictional clauses, came to opposite conclusions. The Tribunal in *SGS v. Pakistan* found that it did not have jurisdiction over SGS' direct claims for breach of contract while the Tribunal in *SGS v. Philippines* held that it did.

The *SGS v. Pakistan* Tribunal first appeared to accept the ordinary meaning of the jurisdictional clause found in Article 9 of the Switzerland–Pakistan BIT. It recognized that:

> "…disputes arising from claims grounded on alleged violation of the BIT, and disputes arising from claims based wholly on supposed violations of the PSI Agreement, can both be described as 'disputes with respect to investments,' the phrase used in Article 9 of the [Switzerland-Pakistan] BIT."[111]

The Tribunal, however, concluded that, despite the ordinary meaning, "we do not see anything in Article 9 or in any other provision of the BIT that can be read as vesting this Tribunal with jurisdiction over claims resting *ex hypothesi* exclusively on contract" and, therefore, "without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in Article 9".[112] Based on this reasoning, the *SGS v. Pakistan* Tribunal declined to assert jurisdiction over SGS' claims for breach of contract.

In contrast, the ordinary meaning of the phrase "disputes with respect to investments" was accepted and given effect by the Tribunal in *SGS v. Philippines*, which concluded that it had jurisdiction over SGS' contract claims. Interpreting the jurisdictional clause in the Switzerland–Philippines BIT, the Tribunal concluded:

> "*Prima facie*, Article VIII is an entirely general provision, allowing for submission of all investment disputes by the investor against the host State. The term 'disputes with respect to investments' … is not limited by reference to the legal classification of the claim that is made. A dispute about an alleged expropriation contrary to Article VI of the BIT would be a 'dispute with respect to investments'; so too would a dispute arising from an investment contract such as the CISS Agreement."[113]

The *SGS v. Philippines* Tribunal listed several factors that supported its interpretation of the jurisdictional clause in Article VIII. It found that the three fora available to resolve disputes under Article VIII—the host State's domestic courts, ICSID panels, and *ad hoc* UNCITRAL tribunals—were all competent "to apply the law of the host State, including its law of contract".[114] Moreover, a foreign investor's ability to choose where to have its contract claims addressed was entirely consistent with a BIT's general purpose of promoting and protecting foreign investment.[115] Further, the Tribunal recognized that "investments are characteristically entered into by means of contracts or other agreements with the host State and the local investment partner";

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111 *SGS v. Pakistan*, *supra*, footnote 1, at para. 161.
112 Id.
113 *SGS v. Philippines*, *supra*, footnote 2, at para. 131 (internal citation omitted).
114 Ibid., at para. 132(a).
115 Ibid., at para. 132(c).

therefore, "the phrase 'disputes with respect to investments' naturally includes contractual disputes".[116] Finally, the Tribunal noted that the State Parties to the Switzerland–Philippines BIT could have limited the jurisdictional clause only to "claims concerning breaches of the substantive standards contained in the BIT", as they did with respect to the settlement of disputes between the State Parties,[117] or that the State Parties could have limited the clause to "claims brought for breach of international standards", as was the case with the North American Free Trade Agreement,[118] but that in each instance the State Parties did not impose any such limits.

The reasoning of the *SGS v. Philippines* Tribunal is entirely persuasive.[119] Moreover, it is not at all a far-fetched proposition that international arbitral tribunals would have jurisdiction over breaches of contracts, and there is no reason to consider that scope of jurisdiction to be overly broad. ICSID tribunals have frequently exercised jurisdiction over contractual disputes on the basis of an ICSID clause in a contract between a State and a foreign investor, particularly in ICSID's early years. Of course, in those cases the jurisdiction of an ICSID tribunal would be limited to disputes arising out of the particular contract—a jurisdictional grant that is much narrower than a BIT's grant of jurisdiction with respect to future disputes under an open-ended number of contracts. However, broad consent is by no means unheard of. Consent to arbitrate disputes with foreign investors can also be found in a State's domestic legislation, where States extend a general offer, or a standing invitation, to all foreign investors to submit to international arbitration (including to ICSID tribunals) any disputes relating to their investments.

For example, the ICSID Tribunal in *SPP v. Egypt* assumed jurisdiction over SPP's claims based on consent to ICSID arbitration given by Egypt in its domestic legislation.[120] Egyptian law provided that all investment disputes in respect of the implementation of the provisions of the Egyptian statute relating to foreign investment could be submitted by the investor to arbitration under the ICSID Convention.[121] Similarly, in *Tradex v. Albania*, the ICSID Tribunal concluded that the Republic of Albania had consented in its domestic legislation relating to foreign investment to ICSID jurisdiction over the dispute before it.[122] The Albanian domestic statute provided that a foreign investor was entitled to submit to ICSID arbitration disputes relating to "expropriation, compensation for expropriation, or discrimination".[123] Kazakhstan's 1994 Law on Foreign Investments

[116] Ibid., at para. 132(d).
[117] Ibid., at para. 132(b).
[118] Ibid., at para. 132(e).
[119] One caveat is necessary. While the *SGS v. Philippines* Tribunal found jurisdiction over SGS' contractual claims, the majority held that the contractual forum selection clause prevailed over the BIT's jurisdictional clause as *lex specialis* (at para. 141) and, therefore, in that specific situation the BIT did not give SGS "an alternative route for the resolution of contractual claims" (at para. 143). For the disagreement of one of the arbitrators, see Professor Crivellaro's Declaration. The Tribunal, however, found that this affected the admissibility of SGS' contractual claims, not the Tribunal's jurisdiction over them (at para. 154).
[120] See *SPP v. Egypt*, Decision on Jurisdiction of 27 November 1985, 3 ICSID Reports 112, 1995, at paras. 64–87.
[121] Ibid., at para. 70.
[122] See *Tradex Hellas S.A. v. Republic of Albania*, ICSID Case No. ARB/94/2, Decision on Jurisdiction of 24 December 1996, 14 ICSID Rev.–F.I.L.J. 161, 1999, at 195.
[123] Ibid., at 174.

provided an even broader scope of consent: the investor was entitled to submit to ICSID any "[d]isputes and disagreements arising in connection with foreign investments or activity connected therewith".[124]

The scope of jurisdictional grants such as those under Egyptian, Albanian, and Kazakh domestic law is even broader than the consent to arbitrate "any disputes" in a BIT, as it covers disputes with any foreign investors, not just the foreign investors from the BIT partner. Therefore, that a State would consent to arbitrate "any disputes" with foreign investors from one specific country, the BIT partner, before an international arbitration tribunal should not be surprising. Indeed, it is the regular practice of the United States to offer foreign investors the choice of international arbitration in cases of disputes relating to "investment agreements", that is, contracts with foreign investors.[125]

For all these reasons, it is hard to agree with the *SGS v. Pakistan* Tribunal that a grant of jurisdiction such as the one found in the Switzerland–Pakistan and Switzerland–Philippines BITs, providing without limitation for the settlement of "disputes with respect to investments", somehow excludes disputes based on alleged breaches of contract. The logic of the *SGS v. Philippines* Tribunal is sounder and much more persuasive. Future tribunals dealing with the same question under similar jurisdictional clauses in BITs will find it difficult to disagree with the *SGS v. Philippines* Tribunal and to revert to the ruling of the Tribunal in *SGS v. Pakistan*.

VI. CONCLUSION

States conclude bilateral investment treaties for the purpose of granting foreign investors the necessary guarantees and protections and obtaining reciprocal guarantees and protections for their own investors. In doing so, States may well decide, through the incorporation of an umbrella clause in the treaty, that breaches of contractual and other obligations undertaken with respect to a foreign investor are to be considered violations of the treaty and, therefore, trigger the responsibility of the State under international law just as would breaches of any other provision of the treaty. States may

[124] Law of the Republic of Kazakhstan on Foreign Investments, 27 December 1994, at Article 27(1)–(2). See also Article 16.2 of the 1996 Investment Law of the Republic of Georgia, providing that "disputes between a foreign investor and a government body, if the order of resolution is not agreed between them, shall be settled at the Court of Georgia or at the International Centre for the Resolution [sic] of Investment Disputes." Both the Law of the Republic of Kazakhstan on Foreign Investments and the 1996 Investment Law of the Republic of Georgia have served as bases for asserting jurisdiction by international arbitration tribunals.

[125] The 1992 U.S. Model BIT, which has served as the basis for subsequent BITs concluded by the United States, provides: "[A]n investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorization granted by that Party's foreign investment authority to such national or company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment." Dolzer and Stevens, *supra*, footnote 78, at Annex 1, pp. 246–247. Moreover, the 2004 Draft U.S. Model BIT also defines disputes to include breaches of (i) an obligation under the substantive protections of the BIT, (ii) an investment authorization, or (iii) an investment agreement; see the 2004 Draft U.S. Model BIT, at Article 24(1)(b), available at: ‹http://www.state.gov/e/eb/rls/prsrl/2004/28923.htm› (last visited on 14 June 2004).

also agree to the submission of contractual disputes with foreign investors to international arbitration tribunals constituted under the treaty without transforming them into treaty disputes.

Extending to foreign investors guarantees that the host State must respect their contractual rights is neither surprising nor unusual, given that in many cases foreign investments take the form of contracts and other binding agreements between the foreign investor and the host State. There is, therefore, no reason why treaty-based tribunals should be reluctant to give umbrella clauses their intended effect or to assert jurisdiction over contractual claims when granted the power to do so by an explicit treaty provision.