

# **Umbrella Clause – A Desirable Instrument ?**

**Dr. Markus Burianski**

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**Inaugural Conference of EFILA**

23 January 2015, London, UK

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# An Overview of the Umbrella Clause and Its Interpretation

# Characteristics

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**Umbrella Clauses are treaty provisions found in a large number of BITs:**

*“Each Contracting State shall fulfil any other obligations it may have entered into with regard to investments in its territory by investors of the other Contracting State.” [Art. 7 German Model BIT]*

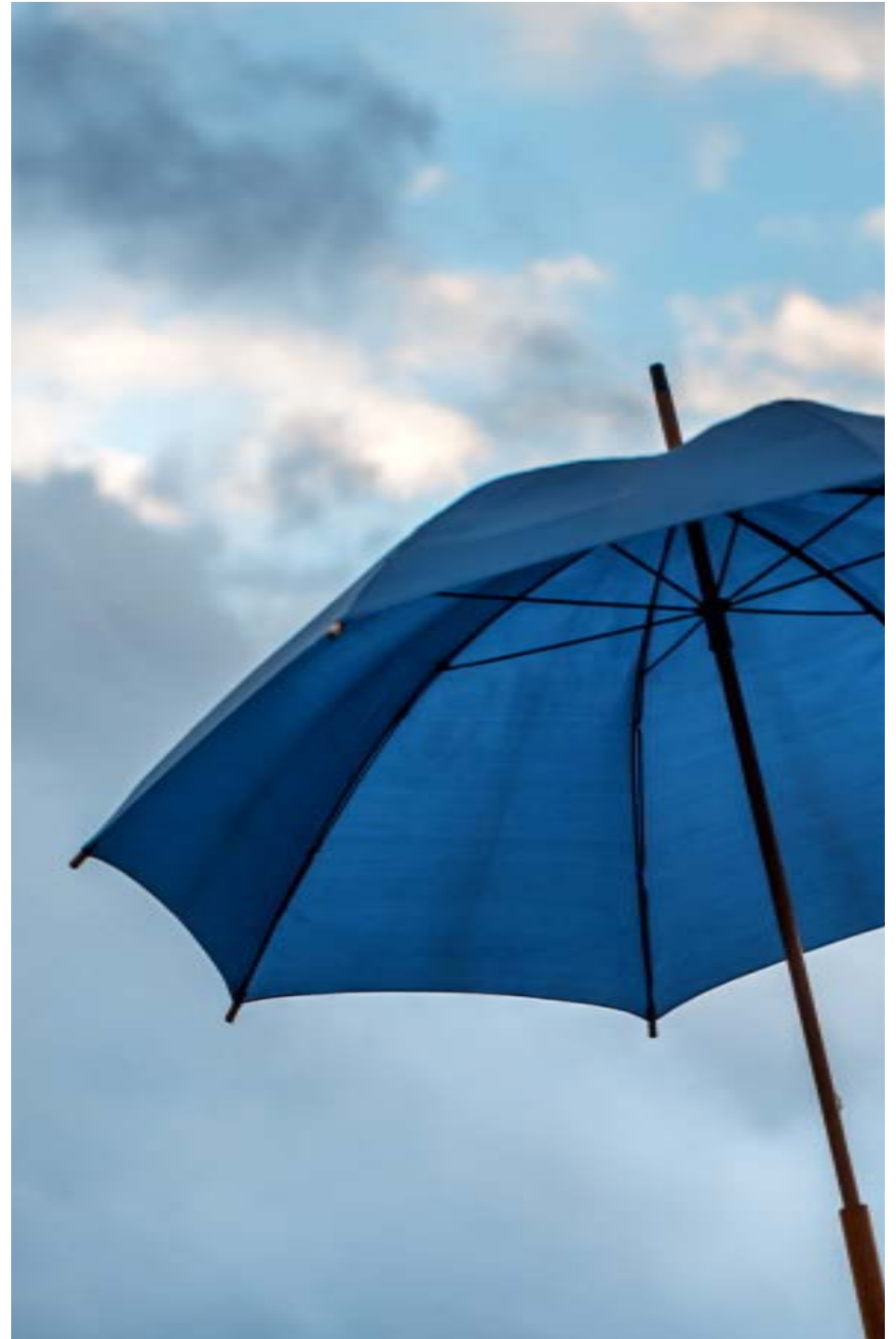
*“Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party.” [Art. 2 UK Model BIT]*

*“Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the other Contracting Party.” [Art. 11 Switzerland-Pakistan BIT]*

# Historic Overview

The first Umbrella Clause was intended to bring an otherwise independent settlement between the AIOC and Iran under the „**protective umbrella**“ of a treaty between Great Britain and Iran.

1959: The first known BIT between Germany and Pakistan contains an Umbrella Clause.



# SGS and the Umbrella Clause

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## **SGS v. Pakistan (2003): restrictive understanding**

- The tribunal refuted the idea that the Umbrella Clause elevated breaches of a contract to a breach of the BIT
  - “The text itself [...] does not purport to state that breaches of contract alleged by an investor in relation to a contract it has concluded with a State [...] are automatically “elevated” to the level of breaches of international treaty law.”
- The tribunal relied on the systematic difference between municipal law and international law and feared the consequences of “almost indefinite expansion” of BIT protection

# SGS and the Umbrella Clause (II)

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## **SGS v. Philippines (2004): broader understanding**

- Specific rejection of the findings in SGS v. Pakistan
- The tribunal decided that the terms of the clause were capable of applying to obligations arising under national law, such as those arising from an investment contract
- However, the arbitral proceedings were stayed because the tribunal found that the BIT did not purport to override the exclusive jurisdiction clause in the investment agreement

# SGS and the Umbrella Clause (III)

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## **SGS v. Paraguay (2010/2012): extensive understanding**

- “One can characterize every act by a sovereign State as a “sovereign act”, including [its] acts to breach or terminate contracts to which the State is a party.”
- The tribunal did not interpret the wording of the Umbrella Clause, but found that every act of the state could potentially breach the treaty
- The forum selection clause in the investment contract was irrelevant in the BIT context



# Summary of Recent Case Law

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**The issue whether or not Umbrella Clauses elevate contractual breaches to breaches of the BIT remains disputed:**

- Exercise of sovereign power – necessary or implied?
- Specific types of contractual obligations concerning investment?
- Impact of forum selection clause in the contract?
- Statutory public obligations as „commitments“ towards the investor?

*There is no legal certainty yet as to the interpretation.*

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Inclusion of Umbrella Clause in TTIP?

# Current State

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- Empirical observation: Germany, UK and the Netherlands frequently include Umbrella Clauses in their BITs, France less frequently
- **Art. X. 9 CETA Agreement:**
  - “For greater certainty, a breach of another provision of this Agreement, **or of a separate international Agreement, does not establish that there has been a breach of this Article** [the fair and equitable treatment standard].“ (emphasis and comment added)
- **Public Consultation Process (TTIP):**
  - “The EU shall also strive, where necessary, to provide protection to foreign investors in situations in which **the host state uses its sovereign powers to avoid contractual obligations** towards foreign investors or their investments, **without however covering ordinary contractual breaches** like the non-payment of an invoice.”

# Arguments pro Umbrella - Why not?

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- Comprehensive protection of investments more attractive for investors
- Neutral dispute resolution forum is the core matter of any BIT
- Better drafting can reduce legal uncertainty

# Arguments con Umbrella – Is it necessary?

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- **Legally:** Legal uncertainty
- **Systematically:** Should international public law be used to solve commercial disputes? Should ISDS be used for settlement of petty disputes?
- **Politically:** Increased public opposition
- Is there really that little trust between EU and US for contractual claims to be dealt with in a satisfactory manner in other dispute settlement procedures?

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Questions?

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Thank you!