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TREATY-PROTECTED INVESTMENT AGREEMENTS: OF UMBRELLA CLAUSES AND PRIVITY OF CONTRACT

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TREATY-PROTECTED INVESTMENT AGREEMENTS:

OF UMBRELLA CLAUSES AND PRIVITY OF CONTRACT

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Abstract: Seemingly the most controversial standard present in investment treaties, the umbrella clause have been stressing parties and arbitrators since 2003 when the issue of its scope was brought up in SGS v. Pakistan. Through the umbrella clause investors have sought to elevate breaches arising out of instruments other than the investment treaty itself, such as contracts and legislations. However, the umbrella clause has another feature. Investors have also relied on the umbrella clause to pursue, under the investment treaty, contractual claims with sub-state entities or, to pursue their subsidiaries’ contractual claims with the State. Also, investors have relied on the umbrella clause to pursue the contractual claims of national companies in which they were shareholders.

INTRODUCTION: THE RISE OF FOREIGN DIRECT INVESTMENT

Foreign direct investments (FDI) are, since the 1980’s, the main source of economic growth in developing countries; and they are often protected by investment treaties, either in the form of a bilateral investment treaty (BIT) or a multilateral investment treaty (MIT, e.g. NAFTA, Energy Charter Treaty), in which States undertake the duty to protect investments made in their territory by the other State’s investors.

Many of these treaties, specially the BITs, contain a rather distinguishable provision that may go unnoticed because of its general wording, but can raise many issues once an investment dispute arises. This provision is the umbrella clause, which seeks to bring under the protecting ‘umbrella’ of the treaty (hence its name), obligations of the States that arises out of instruments other than the treaty itself, like contracts, which are the legal vehicle upon which FDIs are concluded.

Therefore, if a treaty-protected investment contract is breached –in any form– by the host State, and such treaty contains an umbrella clause, the investor might decide to pursue such breach under the law of the BIT (i.e. as a treaty breach). In this scenario, first the tribunal will need to clarify if the umbrella clause can be applied to the contractual obligation breached, that is, if it can be ‘elevated’ to a treaty breach; and second, the tribunal will need to assert whether the scope of the umbrella clause encompasses claims in which the host State or the claimant themselves are not parties to the contract, that is, when the breaching party is a sub-state entity, and/or when the injured party is the investor’s local subsidiary.

2 Chapter 11 of the North American Free Trade Agreement (NAFTA) applies to ‘[...]'measures adopted or maintained by a Party relating to: (a) investors of another Party; (b) investments of investors of another Party in the territory of the Party; and (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.’ (Article 1101)

3 While common in BITs, umbrella clauses may be found in other instruments providing for the protection of international investments. For example, the Energy Charter Treaty (ECT), in its Article 10(1), contains an umbrella clause: Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.'
Arbitral tribunals have been—and continue to be—challenged by the ambiguity in the scope of the umbrella clause. This article discusses how arbitral tribunals, especially ICSID\(^4\) tribunals, have dealt with the issue of privity of contract for the purposes of the application of umbrella clauses, in order to establish if the investor is entitled to seek reparation from the breach of a contract in which it was not a part of, or the other party was an instrumentality of the State, rather than the State itself. At least some uniformity and predictability is needed in this sense, and from the analysis of the cases itself, solutions can be drawn.

**I. THE ROLE OF UMBRELLA CLAUSES**

Back in 1945 foreign investors were not sure that their large-scaled investments were guaranteed by the domestic law of the host State. The umbrella clause, therefore, was seen ‘as a bridge between private contractual arrangements, the domestic law of the host state, and public international law,’\(^5\) giving the investors the legal certainty they were looking for their investments. Already present in the first BIT between Germany and Pakistan (1959), many investment treaties provide for an umbrella clause.\(^6\) However, it wasn’t until 2003 that the clause was given attention, in the case *SGS v. Pakistan*,\(^7\) in which an ICSID arbitral tribunal had to consider the meaning and scope of the umbrella clause contained in the Switzerland-Pakistan BIT.\(^8\)

**A. Elevating Contract Breaches into Treaty Breaches**

The wording of an umbrella clause usually provides that each Contracting State shall undertake to *observe any obligation* it may have entered into with regard to investments of

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4 International Centre for Settlement of Investment Disputes, World Bank
7 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction of August 6, 2003
8 Article 11 of the Switzerland – Pakistan BIT reads as follows: ‘Either Contracting Party shall constantly guarantee the observance of commitments it has entered into with respect to the investments of the investors of the other Contracting Party.’
investors of the other Contracting Party. They normally do not differentiate between undertakings of a commercial nature or sovereign nature. Instead, umbrella clauses are designed to be as general as possible, and so, disagreements have been seen as to the question whether an umbrella clause could ‘elevate’ or ‘transform breaches of obligations provided in a contract into treaty breaches. According to Christoph Schreuer, a renowned scholar in the field of international investment law, umbrella clauses ‘provide additional protection to investors beyond the traditional international standards. 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.’

Nevertheless, interpretation and application of umbrella clauses still remain controversial, since tribunals appear to be unable to agree on their interpretation and effects. One school of interpretation imposes limitations to the effects of the umbrella clause. In SGS v. Pakistan the tribunal rejected the claimant’s argument that the umbrella clause contained in Article 11 of the Switzerland-Pakistan BIT elevated contractual claims into treaty claims. The Tribunal considered that Article 11 was susceptible of ‘almost indefinite expansion,’ meaning that the

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9 A typical umbrella clause reads: ‘Each Party shall observe any obligation it may have entered into with regard to investments’ [U.S. – Argentina BIT Article II(2)(c); U.S. – Romania BIT]. Besides this model, arbitral tribunals have analyzed other formulations of umbrella clauses: (i) ‘Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contractual Party’ [Netherlands – Poland BIT, Article 3(5); UK – Egypt BIT, Article 2(2); Germany – Argentina BIT, Article 7(2)]; (ii) ‘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’ [Switzerland – Philippines BIT, Article 10(2)]; (iii) ‘Either Contracting Party shall constantly guarantee the observance of commitments it has entered into with respect to the investments of the investors of the other Contracting Party’ [Switzerland – Pakistan BIT, Article 11]; (iv) ‘Each Contracting Party shall create and maintain in its territory a legal framework apt to guarantee to investors the continuity of legal treatment, including the compliance, in good faith, of all undertakings assumed with regard to each specific investor’ [Italy – Jordan BIT, Article 2(4)]. See Craig Miles, Where’s my Umbrella? An “Ordinary Meaning” Approach to Answering Three Key Questions that have emerged from the “Umbrella Clause” debate, Chapter 1 in Investment Treaty Arbitration and International Law 3, 7 (T.J. Grierson Weiler ed., 2008)

10 Christoph Schreuer, Travelling the BIT Route: of Waiting Periods, Umbrella clauses and Forks in The Road, 5 J. World Investment & Trade 231, 250 (2004)

11 SGS v. Pakistan, supra note 6, at para. 166

12 Id. at para. 166
commitments falling under the scope of it could be ‘commitments of the State itself as a legal person, or of any office, entity or subdivision (local governments units) or legal representative thereof. . .’. The fact that the article could have such a wide interpretation made the tribunal conclude that its text did not automatically elevate contract breaches into treaty breaches.

In its reasoning, the tribunal gave four reasons for its decision: 1) A far-reaching interpretation of the umbrella clause could give rise to a ‘flood’ of suits, since an unlimited number of contracts as well as State commitments would be under the scope of the umbrella clause; 2) Other provisions of the BIT would be deemed superfluous; 3) Any investor would be able to nullify the choice of forum clauses in their investment contracts; and 4) Article 11 was located at the end of the BIT, reflecting its general nature.

Other cases support the interpretation given in SGS v. Pakistan, some of them using other standards, such as the distinction between the State acting as a merchant and as a sovereign, or the nature and magnitude of the State’s interference with the contract.  

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13 Id.
14 Id.
15 Id. at para. 168
16 Id.
17 Id.
18 Id. at para. 169. According to the tribunal, this meant that Article 11 [umbrella clause] was not a ‘first order’ provision in the BIT and therefore it did not provide substantive international obligations. This reason was found to make no sense by later decisions, like SGS v. Philippines, infra note 21, at para. 124
20 See El Paso Energy International Company v. Argentine Republic, ICSID Case No. ARB/03/15, Decision on Jurisdiction of April 27, 2006, para. 86. The tribunal concluded that it had jurisdiction only over ‘claims based on the violation of an investment agreement entered into by the foreign investor with the State as a sovereign’; Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction of August 3, 2004, para. 248: ‘[F]or the behavior of the State as a contracting party to a contract to be considered a breach of an investment treaty, such behavior must be beyond that which an ordinary contracting party could adopt.’ See also Consortium R.F.C.C. v. Kingdom of Morocco, ICSID Case No. ARB/00/6, Award of December 22, 2003, para. 65
21 See CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Award of May 12, 2005, para. 299. Although the tribunal decided to give full effect to the umbrella clause contained in the US-Argentina BIT, it noted that ‘[p]urely commercial aspects of a contract might not be protected by the treaty in some situations, but the protection is likely to be available when there is significant interference by governments or public agencies with the rights of the investor.’
The other school of interpretation is the one that gives full effect to the umbrella clause. The first tribunal to give broad scope to the umbrella clause was the tribunal in *SGS v. Philippines.* The dispute arose when the Philippines failed to pay amounts due to SGS. The tribunal concluded that, since Article X(2) [umbrella clause] provided that ‘[e]ach Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party’, the Philippines was required to observe its obligations to pay the sums owed to SGS. According to the tribunal, the umbrella clause ‘provide[s] assurances to foreign investors with regard to the performance of obligations assumed by the host State under its own law with regard to specific investments.’ The Tribunal also addressed the concern raised in *SGS v. Pakistan* regarding the ‘flood of law suits.’ It stated that it was not the purpose of Article X(2) of the Switzerland-Philippines BIT, because the umbrella clause didn’t change the proper law of the investment agreement –which was domestic law– into the law of the treaty. It held that the clause addressed ‘not the scope of the commitments entered into with regard to specific investments but the performance of these obligations, once they are ascertained.’

Against the logic of their own reasoning, the tribunal, in a divided holding, decided to stay the arbitral proceeding pending the determination, by Philippine’s courts, of how much money the Government owed SGS. This was an issue of admissibility, because that obligation

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22 *Société Générale de Surveillance S.A. v. Republic of Philippines,* ICSID Case No. ARB/02/6, Decision on Jurisdiction of January 29, 2004
23 *Id.* at para. 115
24 *Id.* at para. 126
25 *Id.*
26 In his declaration, Antonio Crivellaro pointed that ‘It is not clear to me when SGS’ contractual claims, over which our Tribunal declares to have jurisdiction, will become admissible before this Tribunal. I understand that they could be brought again before our Tribunal in case, for instance, of a denial of justice in the Philippines. If SGS’ claims may return to the ICSID Tribunal for a miscarriage of justice (they cannot certainly return in case of a wrong judgment in the merits; we are not a Court of Appeal in respect of domestic courts), this means that our Tribunal is restricting, in practice, its jurisdiction to BIT claims only, after affirming, in theory, that Article VIII and X(2) of the BIT confer on the Tribunal jurisdiction over also purely contractual claims. I fail to see the consistency between the two positions.’
was still governed by the contract and it could only be determined by its terms, that is, through the contractual choice of forum: Philippines courts.27

In *SGS v. Paraguay*28 and *Noble Ventures v. Romania*,29 the Tribunals made a more straightforward effective application of the umbrella clause. In the first case, the Tribunal found that Article 11 of the BIT ‘provides no basis for excluding contracts from the scope of ‘commitments’ covered in the Article,’30 disagreeing with the *Siemens v. Argentina* award, and finding that the umbrella clause may be breached whether or not the exercise of sovereign power is involved.31

In *Noble Ventures v. Romania*, the Tribunal concluded that the wording of the umbrella clause, although very broad in this case,32 clearly referred to investment contracts.33 The Tribunal, in a plain interpretation34 of the umbrella clause, held that ‘in including Art. II(2)(c) in

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27 See also, *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay*, ICSID Case No. ARB/07/9, Decision on Objections to Jurisdiction of October 9, 2012, para. 290. The tribunal decided to stay the proceedings pending a disposition of the alleged contract breach in Paraguayan courts, because it found that the umbrella clause could not override the contractual choice of forum clause. It held that if the state does not comply with any eventual decision by Paraguayan courts, the umbrella clause claim ‘might then become admissible.’


29 *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award of October 12, 2005

30 *SGS v. Paraguay*, supra note 27, at para. 93

31 *Id.* at para. 91. The Tribunal determined that there was ‘nothing in Article 11 that states or implies that a government will only fail to observe its commitments if it abuses its sovereign authority.’ Moreover, the tribunal added that, in disagreeing with the *Siemens* award, it followed the reasoning of other ICSID tribunals, e.g., *Burlington Resources Inc. and others v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)*, ICSID Case No. ARB/08/5, Decision on Jurisdiction of June 2, 2010, para. 190; and *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award of August 18, 2008, para. 320

32 Article II(2)(c) of the US-Romania BIT: ‘Each party shall observe any obligation it may have entered into with regard to investments.’

33 *Noble Ventures, Inc. v. Romania*, supra note 28, at para. 51

34 *Id.* at para. 50. The tribunal stressed the fact that Article II(2)(c) had to be interpreted in accordance with Articles 31 et seq. of the Vienna Convention on the Law of Treaties, ‘[a]ccordingly, treaties have to 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 the object and purpose of the Treaty.’
the BIT, the Parties had as their aim to equate contractual obligations governed by municipal law to international treaty obligations as established in the BIT.'\textsuperscript{35}

The broad interpretation of umbrella clauses can be found in a number of other decisions, confirming the fact that umbrella clauses indeed can elevate contract claims into treaty claims.\textsuperscript{36}

**II. PRIVITY OF CONTRACT: WHO CAN RELY ON THE UMBRELLA CLAUSE?**

As seen above, an umbrella clause will not always apply to contractual obligations. If, however, the contract is deemed to be under the scope of the umbrella clause, the tribunal is then faced with another issue: does the umbrella clause apply only to the parties of the contract (i.e. privity of contract), or does the scope of umbrella clauses extend to cover shareholders/parent companies and sub-state entities?

Arbitration is known to be a creature of consent, that is, arbitration is binding on the parties that have consented to it. However, investment arbitration has been defined as ‘arbitration without privity,’\textsuperscript{37} since BITs, while they are entered into by States they often provide a ‘standing offer’ to arbitrate to the investors.

Case law is also inconsistent in this matter, and the reason is, as for the interpretation, the fact that the wording of umbrella clauses can vary from case to case.

**A. An Umbrella for Sub-States Entities**

Sometimes investment agreements are executed with States’ sub-entities, when such sub-entity has the authorization by the Government to administrate a specific service.

\textsuperscript{35} Id. at para. 61
In Impregilo v. Pakistan, the claimant had entered into contracts with the Pakistan Water and Power Development Authority (WAPDA). The Italy-Pakistan BIT did not have an umbrella clause; however, Impregilo argued that Pakistan had offered such protection to investors under other BITs, and therefore, through the Most Favoured Nation (MFN) clause contained in the Italy-Pakistan BIT, it was entitled to the protection of the umbrella clause.

The tribunal held that even if Impregilo could in fact invoke the umbrella clause through the MFN route, the clause would not offer any protection, because the contracts were concluded with WAPDA and not with Pakistan. It added that ‘[e]ven assuming arguendo that Pakistan . . . has guaranteed the observance of the contractual commitments into which it has entered together with Italian investors [i.e. the umbrella clause], such guarantee would not cover the present Contracts – since these are agreements into which [Pakistan] has not entered.’ The tribunal also relied on the status of WAPDA under Pakistani law, under which the ‘[t]he status and capacity of WAPDA for the purposes of the Contracts, WAPDA is a legal entity distinct from the State of Pakistan.’ The tribunal here relied on the domestic law of Pakistan when it analyzed the scope of umbrella clauses.

In Azurix v. Argentina, the dispute concerned not the breach of a concession agreement with an Argentine instrumentality, but rather with the Province of Buenos Aires. Moreover, the other party to the concession agreement was a subsidiary of Azurix, ABA. The tribunal rejected the claim partly because, ‘[w]hile Azurix [could] submit a claim under the BIT for breaches by Argentina, there is no undertaking to be honored by Argentina to Azurix other than the

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38 Impregilo SpA v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/3, Decision on Jurisdiction of April 22, 2005
39 Id. at para. 223
40 Id. at para. 216
obligations under the BIT.\textsuperscript{41} That is, Argentina’s only obligations towards Azurix were contained in the US-Argentina BIT, and not in the concession agreement, which was entered into by the Province of Buenos Aires.

On the other hand, some tribunals had extended the effects of the umbrella clause to sub-state entities. In \textit{Eureko v. Poland},\textsuperscript{42} the claimant had entered into a contract with the State Treasury, who failed to honor its agreement. The tribunal treated the State Treasury, at all time, as a governmental arm of Poland, and held that all ‘the actions and inactions of the Government of Poland that [were] in breach of Poland’s obligations under the Treaty [i.e. fair and equitable treatment, full protection and security, and indirect expropriation] also are in breach of its commitment under Article 3.5 of the Treaty [umbrella clause].’\textsuperscript{43}

In \textit{SGS v. Pakistan}, the tribunal held that under the international law rules on state responsibility, ‘the “commitments” subject matter of Article 11 [umbrella clause] may . . . be commitments of the State itself as a legal person, or of any office, entity or subdivision (local government units) or legal representative thereof whose acts are . . . attributable to the State itself.’\textsuperscript{44}

The International Law Rules on State Responsibility, codified by the International Law Commission (ILC),\textsuperscript{45} have three articles that are relevant to attribute to the State the conduct of other entities: (a) \textbf{Article 4} describes the entities that are sufficiently connected to the state, so their acts are attributable to the state;\textsuperscript{46} (b) \textbf{Article 5} describes the entities that are not sufficiently

\textsuperscript{41}Azurix Corp. v. Argentine Republric, ICSID Case No. ARB/01/12, Award of July 14, 2006, para. 384
\textsuperscript{42}Eureko B.V. v. Republic of Poland, Partial Award of August 19, 2005
\textsuperscript{43}Id. at para. 260
\textsuperscript{44}SGS v. Pakistan, supra note 6, at para. 166
\textsuperscript{45}The ILC is the United Nations body charged with codifying international law
\textsuperscript{46}Article 4; 1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of
connected to the state to fall within Article 4, but which are given specific governmental authority and whose acts exercising that authority are attributable to the state;\textsuperscript{47} and (c) Article 8 describes entities not sufficiently connected to the state to fall within Article 4 or 5, but whose specific actions are attributable to the state to the extent they are instructed, directed or controlled by the state.\textsuperscript{48}

Following the same reasoning, the tribunal in *Noble Ventures v. Romania* found that the contractual obligations undertaken by two enterprises owned by Romania were its obligations as a state as well. The tribunal held that:

Both entities were clearly charged with representing the Respondent in the process of privatizing State-owned companies and, for that purpose, entering into privatization agreements and related contracts on behalf of the Respondent. Therefore, this Tribunal cannot do otherwise than conclude that the respective contracts were concluded on behalf of the Respondent and are therefore attributable to the Respondent for the purposes of Art. 11(2)(c) [umbrella clause].\textsuperscript{49}

\textit{1. Who decides whether the sub-state entity’s obligation is the State’s obligation as well?}

The issue on this side lies whether the obligations undertaken by sub-state entities are in fact obligations of the State; and to answer this question the ILC rules on state responsibility are helpful, but are not mandatory. Moreover, the domestic law governing the sub-state entity is mandatory, and such law will define the scope of the entity’s autonomy. This last reasoning was applied by the *Azurix* and *Impregilo* tribunals. For the *SGS, Eureko*, and *Noble Venture* tribunals,

\begin{itemize}
\item Article 5: The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.
\end{itemize}

\begin{itemize}
\item Article 8: The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of that State in carrying out the conduct.
\end{itemize}

\begin{itemize}
\item Noble Ventures v. Romania, supra note 28, at para. 86
\end{itemize}
on the other hand, the right approach was that of public international law, that is, the ILC rules on state responsibility.

This gives rise to another and more controversial issue: does the State waived its sovereign immunity in the sense that the arbitral tribunal may decide, without looking to the domestic law, if the sub-state entity had autonomy to contract with the investor? Because State’s waiver of its sovereign immunity in a BIT is to have the arbitrators decide *whether the State breached or not their treaty obligations*.

Therefore, when the issue at stake is whether the breach of the umbrella clause by the State’s instrumentality is a breach attributable to the State, it will be hard for arbitrators not to take a look at the domestic law, including the State’s Constitution. The ILC rules on state responsibility would have higher relevance if the question of the sub-state entity’s autonomy is either absent in the domestic law, or is ambiguous.

This concern is in fact addressed in Articles 25(1) and 25(3) of the ICSID Convention, which gives the contracting States the possibility to designate which of its constituent subdivisions or agencies have also consented to the jurisdiction of ICSID without the need of the State’s approval, meaning that an investor could start arbitration directly against the sub-state entity if such designation is made.

**B. An Umbrella for Shareholders and Subsidiaries**

The other issue on privity of contract and umbrella clauses lays on the side of the investor. Modern BITs and MITs allow investors to make their investment through different ways.

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50 ICSID Convention Article 25(3): Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required  
51 See *NIKO Resources (Bangladesh) Ltd. v. People’s Republic of Bangladesh, BAPEX and PETROBANGLA*, ICSID Case No. ARB/10/11 & ARB/10/18, Decision on Jurisdiction of August 19, 2013, para. 299, in which the Tribunal held that the designation provided in Article 25(3) of the ICSID Convention could even be done implicitly
Investment is often defined as *every kind of asset*,\(^5^2\) including, *inter alia*, shares in a company, intellectual property rights, and contractual rights. Many investments are made through the ownership of such shares in companies of the host State or subsidiaries incorporated specifically for the purposes of the investment, thus giving rise to the question whether the umbrella clause can extend or not to the subsidiary or to the investor itself, when its investment is actually a share in the domestic company that signed the contract. On this matter, a clear differentiation in trends can be seen, depending on whether the investor wants to claim rights owed to its subsidiary, or owed to the company in which it holds shares interest.

For subsidiaries, tribunals have not considered the umbrella clause to reach them. In *Azurix v. Argentina*, besides rejecting the claim under the umbrella clause because the contract was made with the Province of Buenos Aires and not Argentina, the tribunal also rejected Azurix’s claim because the other party to the contract was in fact ABA (claimant’s subsidiary), and not Azurix itself.\(^5^3\) Similarly, the *Siemens* tribunal simply held that the claimant was not a party to the contract and SITS (Siemens’ subsidiary) was not a party to the proceedings.\(^5^4\)

In *Burlington v. Ecuador*, the tribunal made a more thorough analysis to establish if Burlington could rely on the umbrella clause to enforce its wholly owned subsidiary rights under a contract entered into with Ecuador. The tribunal held that the word *obligation* was the ‘operative’ word of the umbrella clause, and in order to define it, two elements had to be

\(^{52}\) Ecuador-Netherlands BIT, Article 1(a)
\(^{53}\) *Azurix v. Argentina*, supra note 40, at para. 384
\(^{54}\) *Siemens v. Argentina*, supra note 35, at para. 204. What is surprising about this decision is the fact that SITS was incorporated by Siemens solely for the purposes of participating in the bidding for the concession of certain services, as required by Argentina; and further in its decision, the tribunal, rejecting the argument by Argentina that concession agreements are different than investments, stated that ‘[t]he term “investment” in the sense of the Treaty, linked as it is to “any obligation,” would cover any binding commitment entered into by Argentina in respect of such investment.’ That is, the concession agreement entered into with SITS would qualify as an investment under the BIT according to this last finding of the tribunal
considered; the fact that someone’s obligation entails the right of another and that obligations exists under the scope of a legal framework, usually the domestic law:

First, in its ordinary meaning, the obligation of one subject is generally seen in correlation with the right of another. Or, differently worded, someone's breach of an obligation corresponds to the breach of another's right. An obligation entails a party bound by it and another one benefiting from it, in other words, entails an obligor and an obligee. Second, an obligation does not exist in a vacuum. It is subject to a governing law. Although the notion of obligation is used in an international treaty, the court or tribunal interpreting the treaty may have to look to municipal law to give it content.  

The majority concluded that based on these two elements, Ecuador’s obligations under the contract were correlated to Burlington’s subsidiary, and that according to Ecuadorian law (the governing law of the contract) there was nothing to support the fact that the non-signatory parent company could directly enforce its subsidiary’s rights.

Also important to mention is the CMS v. Argentina annulment decision, in which the ad hoc committee annulled the part of the award related to the Tribunal’s findings on the umbrella clause. The committee identified five problems with the tribunal’s interpretation of the umbrella clause, which may be hard for further tribunals to ignore. According to the committee, a reasoned interpretation of the umbrella clause would have addressed, inter alia, the following issues: (a) the wording any obligations it may have entered into with regard to investments, of the umbrella clause, was clearly concerned with consensual obligations arising independently of the BIT; (b) consensual obligations are usually entered into with regard to particular persons; and

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55 Brulington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para. 214
56 Id. at para. 215
57 CMS v. Argentina, Annulment Decision of September 25, 2007
58 See e.g. El Paso v. Argentina, Award of October 31, 2011, paras 178-189, 190-198, 533
(c) if the content and proper law of the obligation are not changed by the umbrella clause, then the parties to the obligation should not change either.\textsuperscript{59}

The CMS annulment committee and the Burlington tribunal certainly gave a standard to analyze whether the investor could claim the breach of a contract entered into with the intermediate company: the domestic law that governs the contract, which normally requires privity in order to assert which parties owe each other obligations.

On the other hand, tribunals have found that when the investment is made through the purchase of shares in a national company, the investor, as a shareholder, might have a right to claim the breach of obligations owed to the company in which they own shares, when such breach affects the value of the shares, i.e., the investor’s investment. In the dispute between CMS and Argentina, the tribunal found that Argentina breached the umbrella clause of the US-Argentina BIT by failing to fulfil the obligations entered into with TGN, the Argentine company in which CMS was a minority shareholder. Although its findings were later annulled for failure to state reasons, it is clear that the tribunal found reasons to protect the rights of a foreigner that owned a minority share interest in a national company as was CMS. The tribunal’s reasoning was that, for the purposes of finding jurisdiction, it did not matter if the investor was a party to the concession agreement with the host State because there was a direct right of action of the shareholders.\textsuperscript{60} In \textit{EDF v. Argentina}, the tribunal was faced with a situation similar to Azurix. The investor in this case was a majority shareholder of EDEMESA, a company that contracted with the Province of Mendoza. Unfortunately, the tribunal was not clear in recognizing the right

\textsuperscript{59} CMS v. Argentina, supra note 56, at para. 95. The other reasons given by the Annulment Committee were: (a) the broad interpretation empowers the claimant to enforce the local subsidiary's contractual rights even though the claimant is not obliged to fulfil the subsidiary's contractual obligations, including the obligation to resolve the dispute in the contractually agreed forum; and (b) the interpretation makes the mechanism in Article 25(2)(b) of the ICSID Convention unnecessary wherever there is an obligations observance clause.

\textsuperscript{60} CMS v. Argentina, Decision on Jurisdiction of July 17, 2003, para. 65
of the investor, as a shareholder, to claim obligations due to EDEMSA. But it did mention that the breach of the Province was clearly a governmental act, and that the concession agreement made ‘explicit mention of shareholders.’

In *Enron v. Argentina*, a more in-depth analysis of the case was made. Here claimant also owned a minority share interest in TGS, another Argentine company for the transportation and distribution of gas. The Tribunal found that Enron was in fact invited by the Government of Argentina to participate in the investment connected to the privatization of TGS. The tribunal considered that the investor’s ‘technical expertise . . . was one of the elements required to materialize their participation in the process’ and that, Enron had certain decision-making power in the management of TGS. After these findings, the tribunal concluded that ‘the participation of the Claimants was specifically sought [by the Government] and […] they are thus included within the consent to arbitration given by the Argentine Republic. . . [Claimants] are beyond any doubt the owners of the investment made and their rights are protected under the Treaty.’

According to *Enron*, the acts of the Argentine Government were decisive to assert its will to have Enron as a foreign investor, and therefore, enjoy the protection of the BIT, including both the umbrella clause and ICSID arbitration. This approach is indeed helpful, because it addresses the reasonable expectations of the investor under the fair and equitable treatment standard, by which States parties to a treaty must ‘provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.’

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63 *Id.* at para. 56
64 *Técnicas Medioambientales TECMED S.A. v. México*, ICSID Case No. (AF)/00/2, Award of May 29, 2003, para. 154
CONCLUSIONS AND FINAL CONSIDERATIONS

The umbrella clause can be a powerful tool for investors. The clause can allow them to bring not only breaches of contract to the investor-state arbitration proceedings, but also different parties to their claims against the State, being that party the shareholders, their subsidiaries, or the State’s instrumentalities.

The stream of reasoning of the case law analyzed shows that tribunals are yet to come to an agreement with regards to the interpretation and application of umbrella clauses, mainly because States are free to define the scope of the treaty they enter into and the guarantees granted therein. Still, opposite decisions can be found in the interpretation of identical umbrella clauses. This inconsistency and unpredictability are main reasons for the current backlash against investor-state arbitration.

So, should umbrella clauses just be eliminated from the standards of protection provided in BITs and MITs, granting the investors only the protections of fair and equitable treatment, full protection and security, and expropriation, which are less controversial? Of course this is a matter better left for another analysis, since any discussion regarding the elimination of umbrella clauses in one paragraph would be irresponsible.

Still, it is not fair to see umbrella clauses – and investor-state arbitration – as a mechanism by which investors can take advantage of States. The aim is not a way to take money from the States by any means possible; it simply helps foreign investors be sure about their investments.

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65 Dolzer, supra n. 4, at 174: ‘If the parties choose to extend the scope of the agreement beyond the confines of the classical understanding of an investment treaty and also cover operations previously deemed “commercial” or “contractual” in nature, conventional terminology cannot stand in the way of the parties’ intentions.’

66 In the cases of SGS v. Pakistan and SGS v. Paraguay, the tribunals analyzed identical umbrella clauses. Article 11 of the Switzerland-Pakistan BIT and Article 11 of the Switzerland-Paraguay BIT both provide that ‘[e]ither 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.’

67 This is the main protest against the signature of the Trans-Pacific Partnership (TTP) and the Transatlantic Trade and Investment Partnership (TTIP). See Elizabeth Warren, Kill the Dispute Settlement language in the Trans-Pacific
Thus, for the sake of *jurisprudence constante* and the legal certainty of the system, consistency and predictability is needed. The inconsistency in the interpretation of umbrella clauses can be assessed. Future BIT drafters, if they will include an umbrella clause, can and must specify clearly whether the clause applies to sub-state entities obligations, and whether the clause applies to obligations owed to the investors’ subsidiaries or to the company in which they are shareholders. Specifically for sub-state entities, tribunals can also address the issue of privity by agreeing on how to harmonize the application of the domestic law and the ILC rules on state responsibility, in order to attribute responsibility to States deriving from their instrumentalities’ acts.