Umbrella Clauses, Will Theory and Forum Selection Clauses

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A. The Institution of Promising .................................................................4
   I. Contract is within the Core Meaning of “Obligation Assumed” ..................4
   II: Unilateral Undertakings and the Penumbra ........................................7
B. Legal Effects of Umbrella Clauses ........................................................9
   I: Narrow Readings .............................................................................13
   II. Wide Readings ................................................................................17
   III. A Mere Difference in Language? ......................................................18
C. Overlapping Claims and Forum Selection Clauses ....................................20
D. Conclusion ............................................................................................26

Abstract

Umbrella clauses in investment treaties ostensibly give rise to second-order derivative treaty obligations to observe first-order obligations. The interpretation of the ambit of umbrella clauses has proven to be highly controversial, with a marked jurisprudential split between two lines of arbitral decisions. In this paper, I utilize H.L.A. Hart’s distinction between core and penumbra meanings and the will theory of contract to show that umbrella clauses should be read widely to include contractual obligations. I then go on to analyze forum selection clauses in underlying contracts, which exemplify the intersection between the international and municipal legal orders and potentially lead to a multiplicity of actions. I conclude that an investor should not be allowed to approbate and reprobate on the underlying contract: arbitral tribunals should stay proceedings if the contract includes an exclusive forum selection clause.

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Many investment treaties contain an “umbrella clause”, whereby contracting states undertake to observe obligations entered into vis-à-vis investors of the other contracting state(s).

Although the language used is deceptively simple, the interpretation of umbrella clauses has proven to be highly controversial in practice. In particular, two apparently irreconcilable ICSID decisions, SGS v. Pakistan¹ and SGS v. Philippines,² exemplify the jurisprudential split over the proper scope and function of umbrella clauses. Beyond this fundamental divide, there is also little analysis by arbitral tribunals of the intersection between umbrella clauses and issues of conflict of laws, in particular where litigants have contractually bargained for choice of forum clauses.

Umbrella clauses are typically widely drafted and ostensibly give rise to a treaty obligation on contacting states to observe obligations entered into with regard to investments. The umbrella clause obligation, regardless of its scope, is a derivative second-order obligation to ensure the performance of a first-order obligation. Put another way, a violation of a first-order obligation is a conditio sine qua non for a violation of a second-order treaty obligation. A foreign investor who wishes to prove a derivative treaty breach would first have to show a first-order breach of contract by the host state. However, the investor should not be allowed to approbate and reprobate on the contract. He

must take the benefits of the contact along with the burdens. As most commercial contracts have forum selection clauses, further complications arise. If the question of contractual breach is adjudicated on by an international tribunal, applying the principles of conflicts of laws and consequently a municipal law if need be, this allows the investor to evade his contractual choice of forum, and thereby reprobate on the contract. The issues involved ultimately stem from the complex interaction of two legal orders: at the international level over a breach of treaty, and at the municipal level over a breach of contract.

In Part A, I use H.L.A. Hart’s distinction between core and penumbra meanings to analyze the phrase “obligation assumed”. I go on to invoke the will theory of contract to show that the legal institution of contract (and the international legal institution of treaty, insofar as treaties are a subset of contracts) is indubitably within the core meaning of “obligation assumed”. Contrariwise, unilateral undertakings are within the penumbral meaning of “obligation assumed”. I demonstrate how will theory can be utilized as an analytical yardstick to mitigate this linguistic ambiguity, and demarcate the first-order obligations which can lead to second-order treaty obligations. In Part B, I apply the Vienna Convention on the Law of Treaties to analyze the legal effects of umbrella clauses. Particular attention is paid to the jurisprudential split between the SGS v. Pakistan and SGS v. Philippines lines of cases. I conclude that the narrow reading of umbrella clauses, as advocated by the SGS v. Pakistan line of cases, is erroneous. In Part C, I analyze forum selection clauses, which exemplify the intersection between the
international and municipal legal orders. Where an investor has contracted for
an exclusive forum selection clause in the underlying contract, he ought to be
held to his bargain. Any actions initiated outside of the stipulated contractual
forum should be stayed. If the investor were allowed to sue via the
mechanism stipulated in the BIT, this would be tantamount to an evasion of
his contractual obligations. Finally, I conclude with some remarks in Part D.

A. The Institution of Promising

A typical umbrella clause is phrased thusly: “Each Contracting Party shall
observe any obligation it has assumed with regard to investments in its
territory by nationals or companies of the other Contracting Party.”

“Obligation” is defined as “something (as a formal contract, a promise, or the
demands of conscience or custom) that obligates one to a course of action”.4
“Assume” is defined as “to take to or upon oneself: undertake <assume
responsibility>”. 5 The use of the word “assume” connotes a sense of
voluntariness.

I. Contract is within the Core Meaning of “Obligation Assumed”

H.L.A. Hart distinguished between the core and penumbral meanings of
words and phrases: “[t]here must be a core of settled meaning, but there will
be, as well, a penumbra of debatable cases in which words are neither

3 German Model BIT 1991. “Observe any obligation” is found in the vast majority of BITs with
umbrella clauses. For a survey, see Katia Yannaca-Small, Interpretation of the Umbrella
Clause in Investment Agreements, Working Papers On International Investment No. 2006/3
4 Merriam-Webster’s Collegiate Dictionary, 856 (11th ed. 2003)
5 Merriam-Webster’s Collegiate Dictionary, 75 (11th ed. 2003)
obviously applicable nor obviously ruled out”. As such, an “obligation it has assumed” manifestly and clearly rules out duties that are imposed by the law. Duties stemming from the law of tort (or delict) are clearly ruled out: tortious duties are typically imposed on general classes of actors engaging in certain classes of activities, regardless of their consent. Duties stemming from the law of restitution (or autonomous unjust enrichment) – in other words, duties which are premised solely on an unjust gain and not an antecedent tortious or contractual wrong – are also clearly ruled out. Take the seminal case of a person who has unwittingly received some money in his bank account as a result of a mistaken transfer: it would be nonsense to say that the recipient’s resultant duty to restore the money is based on consent.

The core meaning of “obligation assumed” indubitably covers the institution of contract. The classical will theory of contract stipulates that certain promises are enforceable because the promisor has willed to be bound by his promissory commitment. Cohen characterizes the theory thusly: “the law of contract gives expression to and protects the will of the parties, for the will is something inherently worthy of respect”. Although numerous commentators have objected to the theory on both a posteriori and a priori grounds – this does not detract from the usefulness of the theory in explaining a certain

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7 For instance, in common law parlance, an automobile driver has a duty of care to ensure that he does not cause unreasonable harm to other road users.
8 Cohen, *The Basis of Contract*, 46 Harv. L. Rev. 553, 575 (1933)
9 I.e. the metaphysical difficulties of requiring a subjective enquiry into promisor intent. The realist critique also point outs, *inter alia*, that political discourse masquerades as law and that freedom of contractual will, in particular, is potentially illusory; see e.g. Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller’s ‘Consideration and Form’* 100 Colum. L. Rev. 94, 123-124 (2000) for a summary of realist views.
10 I.e. that the theory is incomplete and cannot account for certain enforceable contracts - for instance, where offer and acceptance are non-contemporaneous and the parties are never truly *ad idem*. 
subset of the rules of contract. As Fried argues, a person “is morally bound to keep his promises because he has intentionally invoked a convention whose function it is to give grounds – moral grounds – for another to expect the promised performance”. 11

Treaties 12 and contracts 13 both involve legally enforceable promises. There are only two differing features: first, treaties can only be concluded between states; there are usually no restrictions on the identity of contracting parties. 14 Second, treaties can only be governed by international law; contracts can be governed by any system of law. As such, treaties are merely a special subset of contracts exhibiting certain characteristics. Of course, states can enter into contracts between themselves that do not constitute treaties – viz., where the law governing their obligations is not international law.

However, “obligation” is usually not qualified by the adjective “contractual”; as such, commentators have speculated that “obligation” potentially extends to non-contractual obligations. 15

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11 Charles Fried, Contract as Promise 16 (1982)
12 Vienna Convention on the Law of Treaties art. 2(1), May 23, 1969 states: “treaty’ means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”
13 Restatement (Second) of Contracts §1 (1981) states: "A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty”; Code Civil §1101 (Fr.) states that “A contract is an agreement which binds one or more persons, towards another or several others, to give, to do, or not to do something”; in English common law a contract “is an agreement giving rise to obligations that are enforced or recognized by law”: G. Treitel, The Law of Contract, 1 (11th Ed., 2003)
14 Subject, of course, to the requirement that natural persons are sui juris and artificial persons have legal personality
II: Unilateral Undertakings and the Penumbra

Unilateral undertakings are within the penumbra of “any obligation it has assumed”, and are neither clearly applicable nor ruled out. Will theory can be used as an analytical yardstick to mitigate the inherent linguistic penumbral ambiguity, and provide a firmer conceptual basis for the demarcation of the first-order obligations that can lead to second-order treaty obligations.\(^\text{16}\)

This already has a basis in the law. In some municipal systems, a unilateral declaration can itself be evidence that the promisor is willing to be contractually bound to a certain class of (potentially unenumerated) persons. In the seminal English case of *Carlill v Carbolic Smoke Ball Company*\(^\text{17}\), the Carbolic Smoke Ball Company claimed that it would pay a £100 reward to anyone who got sick with influenza after using its product, and deposited £1000 with a bank to demonstrate seriousness. This was not construed to be a unilateral statement *per se*. Rather, it was construed to be a standing offer to the world, which ripens into a contract whenever someone comes forward and fulfills the stipulated conditions.

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\(^{16}\)The same principle applies, even where the BIT uses language like “commitment” instead of “obligation”. At first glance, a commitment might appear to be wider than an obligation. This is illusory: ultimately both terms are question-begging and require further explication. I have proposed in this paper that “obligation”, “commitment”, and other near-synonymous terms of their ilk have to be understood in the context of will theory; the primacy of the will to be bound remains unchanged regardless of one’s choice of synonym.

\(^{17}\)[1893] 1 Q.B. 256
Undoubtedly, the same principles apply to obligations governed by international law. In the *Nuclear Tests* cases, the International Court of Justice clearly referenced will theory:

“It is well recognized that declarations made by way of unilateral acts, concerning legal or factual situations, may have the effect of creating legal obligations... When it is the intention of the State making the declaration that it should become bound according to its terms, that intention confers on the declaration the character of a legal undertaking, the State being thenceforth legally required to follow a course of conduct consistent with the declaration. An undertaking of this kind, if given publicly, and with an intent to be bound, even though not made within the context of international negotiations, is binding.”

Clear and convincing evidence of an intention to be legally bound should be required before a tribunal concludes that an obligation has been assumed. In most cases, explicit language - which states that the state intends to be bound – should be required. Without going so far as to state that it is *a priori* impossible to find the requisite intention without such explicit language, the fundamental question is thus: if the state *did* intend to be bound, why did it not evince this via an explicit statement or, alternatively, utilize the vehicle of a contract?

Mere administrative acts, without more, should not be adequate evidence of such an intention. Take the case of a state which has a practice of granting

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licenses to regulate certain activities: the mere act of granting the license to a particular individual should not ground an inference that the state intends to be legally bound to authorize activity for that individual in perpetuity. It might be different, however, if the license is accompanied by a statement which states that the license shall not be revoked for 5 years, or that the license may only be revoked if certain conditions are met. Even then, further inquiries into the institutional structure of the state are needed – it could be that the licensing authority is acting *ultra vires*.

The same requirement of clear and convincing evidence applies, *a fortiori*, to legislative acts. Where, for instance, legislation is ordinarily repealable by a simple majority in the legislature, the mere passage of a statute should not be sufficient evidence to warrant the inference that the state intends to grant irrevocable, legally binding rights to a certain class persons. Again, it might be different if, for example, the head of the legislature, with control of a party whip, represents that the legislature does not intend to repeal certain legislation during its five-year term in power.

**B. Legal Effects of Umbrella Clauses**

Certain institutional rules ineluctably flow from the premise that will is foundational to contract:

1. A bare promise is elevated to the level of legal contractual enforceability if the parties involved will it to be so.
2. The contracting parties can agree that contractual obligations stemming from the legally enforceable promises are owed to a class of beneficiaries.
   
a. Although obligations are typically owed to the promisee, there is nothing stopping the parties from designating that the obligation is to be performed for a benefit for a third party beneficiary.

3. The parties can intend for contractual obligations to be enforceable at the instance of the class of beneficiaries.

4. Contractual promises, and hence contractual obligations, can only be altered (or even revoked) if contracting parties agree to such an alteration or revocation.
   
a. This of course does not exclude the loss of contractual rights to performance via for example acquiescence.

It thus follows that

5. The third party beneficiary may enter into a subsequent contract with the promisor to modify or revoke his contractual right to performance.

To the extent that BITs purport to create obligations owed to third party investors – namely, the right to submit to arbitration a claim that an underlying contract has been breached – such obligations are in principle capable of being modified by subsequent contracts between the state party and third party investors.
Before going on to examine in detail how umbrella clauses in BITs interact with contractual forum selection clauses, it is apposite to first determine the legal effects of umbrella clauses, and the obligations that such clauses entail.

Article 31 of the Vienna Convention on the Law of Treaties (“Vienna Convention”) states 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.”

The ordinary meaning of the phrase “any obligation it has assumed” indubitably includes, at its core, entering into a legally binding agreement and being thereby legally bound to pursue certain courses of action. This comports with the earlier discussion on will theory, where it was pointed out that the legally enforceability of certain promises are precisely justified on the basis of the promisor’s willingness to be bound; “any obligation… assumed” is synonymous for this willingness to be bound. One is legally obliged to fulfill one’s contractual promises. Such first-order contractual obligations are ipso facto elevated, via umbrella clauses, to second-order treaty obligations.

The preamble language of a treaty can also serve as a useful indicator of its object and purpose. BITs normally contain preambles to the effect that the state parties desire to promote greater economic cooperation or intensify economic relations and recognize that agreement will stimulate the flow of private capital and lead to economic development. Virtually all BITs are titled

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19 Preambles may serve as “useful aids to interpretation of the treaty”: Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties, 20 (1995)
“A Treaty Concerning… Protection of Investment”. BITs provide clear rules and effective protection mechanisms to investors. Without a BIT, investors are forced to rely on uncertain, contested principles of customary international law and often have to resort to local courts, where they face the risk of bias and governmental interference. It stands to reason that interpreting “any obligation it has assumed” to encompass contractual obligations – thus strengthening the protection of investment – is entirely in accordance with the object and purpose of BITs.

Article 32 of the Vienna Convention further states that “[r]ecourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31…”. The use of “includes” indicates that Article 32 is non-exhaustive; it is permissible to refer to Contracting Party views on the interpretation of umbrella clauses. According to the Swiss government, umbrella clauses:

"are intended to cover commitments that a host State has entered into with regard to specific investments of an investor, or investments of a specific investor... Most typically but not exclusively, such commitments by the host State would be in the form of an investment authorization by the competent authority of the host State or a written agreement between the host State

21 Id. at 75
or a competent authority of that State, on the one hand, and the investor, on the other.”

[emphasis added]

Article 38 of the Statute of the International Court of Justice specifies that the court, in deciding cases in accordance with international law, is to apply “...judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law”. I shall now turn to arbitral decisions which have adjudicated on the scope of umbrella treaties.

I: Narrow Readings

SGS v Pakistan concerns a contract between the Government of Pakistan and Société Générale de Surveillance S.A (“SGS”), whereby SGS contractually undertook to provide “pre-shipment inspection” services with respect to goods to be exported from certain countries to Pakistan. This was aimed at ensuring that goods were classified properly for custom taxation purposes. SGS alleged that Pakistan unlawfully terminated the contract, and had also failed to pay in full for services rendered. Pakistan asserted that the

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22 Vienna Convention on the Law of Treaties Art 31(3)(b), May 23, 1969 – which stipulates that there shall be taken into account, together with the context, “any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation” could also potentially be used. Unilateral statements can themselves be looked at as subsequent practice.


ICSID tribunal did not have any jurisdiction because the claims, “irrespective of how SGS labels them, are entirely contractual in nature”.

Article 11 of the Switzerland-Pakistan BIT states: “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.”

The tribunal reasoned that the text of Article 11 does not purport to state that breaches of contract are automatically elevated to a breach of international treaty law. Under general international law, a violation of a contract entered into by a state is not, by itself, a violation of international law. Further, an interpretation of Article 11 to include contracts would entail legal consequences “far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party”, and “would amount to incorporating by reference an unlimited number of State contracts”. This would also render substantive treaty standards – for instance, fair and equitable treatment – superfluous. Lastly, an investor would always be able to defeat a state’s invocation of a contractually specified forum by using the BIT’s dispute resolution mechanism.

With respect, these objections are unconvincing. As my foregoing analysis demonstrates, a straightforward application of the Vienna Convention shows that umbrella clauses should extend to contractual commitments. To reiterate,
it is difficult to envisage a more paradigmatic case of a “commitment [a state] has entered into” than a contract. More specific language indicative of a shared intent should not be required.

It is also doubtful that the “incorporation of an unlimited number of contracts” will lead to unwarranted burdensome effects. Umbrella clauses do not create any new freestanding substantive obligations, and are derivative of underlying first-order obligations. If an underlying obligation is duly performed, the corresponding derivative umbrella clause obligation is thereby ipso facto discharged. If an underlying obligation is breached, then a remedial obligation – for instance, to pay damages – arises. The umbrella clause merely elevates the remedial obligation to the level of a treaty obligation. Particularly in the context of contractual obligations, there are no burdensome effects that states have not freely assumed. I shall analyze the issue of forum selection clauses in Part C. Suffice to say, it would be artificial to control such problems by utilizing a restrictive interpretation.

Substantive treaty standards, embodied elsewhere in BITs, would also not be made superfluous. Individual investors do not normally bargain for such standards to be included on a contract-by-contract basis, possibly because of the high transactional costs involved or a lack of bargaining power. Contrariwise, Pakistan’s restrictive reading eo ipso gives the umbrella clause little bite and makes it ineffective, if not entirely superfluous.

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25 An analogy may be drawn with tort. The tort of negligence supplements contract where the transactional costs are potentially infinite – a pedestrian, desirous of protecting against injury, cannot possibly contract, on an individual basis, with every single potentially negligent driver to owe a contractual duty of care.
El Paso v. Argentina\textsuperscript{26} agrees with the reasons proffered in Pakistan, but goes one step further and holds that acts \textit{jure imperii} and \textit{jure gestonis} have to be distinguished. Article II(2)(c) of the US-Argentina BIT reads:” Each Party shall observe any obligation it may have entered into with regard to investments”. According to the tribunal, umbrella clauses do not apply to “breaches of an ordinary commercial contract entered into by the State... but will cover additional investment protections contractually agreed by the State as a sovereign”. The umbrella clause was to be read in light of Article VII (1),\textsuperscript{27} which, in the tribunal’s view, defined “investment disputes” as referring only to acts \textit{jure imperii}. The reference to Article VII (1) is textually unwarranted – and ultimately question-begging - as “investment agreement” is itself undefined in the treaty. Irrespective of the content of Article VII, there ought to be a conceptual distinction between clauses that impose substantive obligations and clauses which establish procedural mechanisms and prescribe jurisdiction to certain tribunals; the former should not be read in light of the latter.

El Paso proffers a further reason for a restrictive interpretation: it criticizes the reasoning of SGS v. Philippines, where the tribunal in Philippines stated that an umbrella clause “does not convert the issue of the \textit{extent or content} of

\textsuperscript{26} El Paso Energy International Company v. Argentine Republic, ICSID Case No. ARB/03/15, Decision on Jurisdiction, (Apr. 27, 2006)

\textsuperscript{27} 1. For purposes of this Article, an 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 (if any such authorization exists) to such national or company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment.
such obligations into an issue of international law” (original emphasis). The tribunal in *El Paso* stated that, in *Philippines* “a treaty claim should not be analyzed according to treaty standards, which seems quite strange”. This betrays conceptual confusion. A tribunal, in enforcing an umbrella clause, is applying an international standard: *viz.*, a rule of conflict of laws, which identifies the system of law to be applied to the issue of breach of the underlying obligation. For most treaty obligations this is trivial – by virtue of Article 2 of the Vienna Convention on the Law of Treaties, the system of law to be applied to a treaty is international law. An umbrella clause obligation, as explained above, is unique and is derivative of an underlying (contractual) obligation. In applying international law to the issue of whether an umbrella clause obligation is owed, the incidental question of contractual breach arises - which is not *ipso jure* governed by international law. An international law tribunal will then have to determine, via a conflict of law rule, which system of law is to govern the purported contractual breach. The governing system of law intended by the parties to the contract will oft be stipulated expressly, and in accordance with the prior discussion on will theory, ought to be respected by the tribunal. In ICSID arbitrations, Article 42(1) mandates the application of “rules of law as may be agreed by the parties”.

II. Wide Readings

28 See also Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, (May 11, 2005); Eureko B.V. v. Republic of Poland, Partial Award and Dissenting Opinion, Ad Hoc—UNCITRAL Arbitration Rules, IIC 98 (2005); Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/ 01/11, Award, (Oct. 12, 2005); LG&E Energy Corp v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, (Oct. 3 2006)
SGS v Philippines concerns a contract between SGS and the Government of Philippines whereby SGS contractually undertook to provide pre-shipment inspection services with respect to goods to be imported into the Philippines. SGS asserted that the Philippines failed to pay certain contractually owed sums.

Article X(2) of the Swiss-Philippines BIT reads: “Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party.”

The tribunal, without citing to the Vienna Convention, held that the umbrella clause does cover contractual obligations. A plain reading of the text supports this; the text also “has to be construed as intended to be effective”. The object and purpose of the BIT – i.e. the promotion and reciprocal protection of investments – also means that it is “legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments”.

The tribunal's reasoning comports with my foregoing analysis. To reiterate, such a broad interpretation also accords with the will theory of contract, where it was pointed out that a promise is contractually binding precisely because a party has willed to be bound; “any obligation assumed” is merely synonymous with this.

**III. A Mere Difference in Language?**
It might be objected that my analysis only holds where the language “observe any obligation assumed” is used, and that *SGS v Pakistan* can be distinguished on the basis that the language used - “constantly guarantee the observance of commitments it has entered” - is weaker and does not cover contractual obligations.

I beg to differ. The phrase “constantly guarantee” is stronger than “observe”. “Guarantee” is defined as to “engage for the existence, permanence, or nature of: undertake to do or secure”.29 “Constant” is defined as “marked by firm steadfast resolution or faithfulness: exhibiting constancy of mind or attachment”.30 Contrariwise, “observe” has weaker connotations: “to conform one’s action or practice to (as a law, rite, or condition): comply with”.31

“Obligation”32 and “commitment”33 are virtually synonymous. Central to the claim that the language in *Pakistan* is weaker is the effect of the adjective “any”. “Any” is defined as “used to indicate one selected without restriction”.34 An unqualified plural noun *simpliciter* is definitionally identical to the singular form of the noun qualified by “any”. Let the following two sentences demonstrate:

**Sentence A**

Any child innately knows that murder is wrong.

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32 Supra, note 4
33 “Commitment” is defined as "an agreement or pledge to do something in the future". See Merriam-Webster's Collegiate Dictionary, 250 (11th ed. 2003)
34 Merriam-Webster's Collegiate Dictionary, 56 (11th ed. 2003)
Sentence B

Children innately know that murder is wrong.

I submit that both sentences A and B convey the same meaning; neither is stronger than the other. If one accepts that “constantly guarantee” is stronger than “observe”, the language used in the Swiss-Pakistan BIT is actually more emphatic than the language used in the Swiss-Philippines BIT, and is a clearer exhortation that one ought to be bound to one’s underlying contractual obligations.

C. Overlapping Claims and Forum Selection Clauses

If the wide interpretation is indeed correct, further complications arise.

Formally, a treaty breach, with its concomitant procedures for dispute resolution is distinct from a contractual breach, with its own concomitant procedures for dispute resolution. A plaintiff claiming on both grounds would simply be pursuing two separate causes of action.

Umbrella clauses are premised on the breach of an underlying (contractual) commitment. Although the treaty and contractual claims are, in a sense, distinct, they both arise out of the same set of facts – i.e. that there was a breach of contract. For a contract claim *simpliciter*, one is claiming that the promisor has breached the contract, and is thereby entitled to damages. For the treaty claim, one is claiming that the promisor has breached the contract,
and that this breach of contract is itself a breach of treaty; one is thus thereby entitled to damages. To reiterate, the breach of treaty is parasitic on a breach of contract.

In adjudicating on a breach of treaty, an arbitral tribunal has to thereby adjudicate on an underlying contractual breach. This leads to the familiar problem of overlapping jurisdictions and forum shopping, which is relatively new in the context of international investment arbitration.35

As my foregoing analysis has shown, the BIT is a public international law agreement that is entered into between the defendant state and the state of which the investor is a national; a right to sue the host state using certain specified mechanisms is vested in the investor, who is a third party to the treaty.

The exercise of a right to sue requires action. Legal systems do not aid the idle:36 a party must, on his own initiative, seek legal advice and initiate legal proceedings. The automatic initiation of legal action is impossible and would require an omniscient legal system. This is also a consequence of will theory: as the vested treaty right to sue is for his benefit, it is for the investor to decide if he wishes to pursue his secondary entitlement to damages. An investor could simply decide that he does not wish to take legal action for various

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36 E.g. the latin maxim *vigilantibus non dormientibus aequitas subvenit.*
reasons: perhaps the risk of failure is unacceptable, or more pertinently, the alleged wronger is willing to settle or come to a compromise out of court. This is tantamount to a *de facto* variation of contractual commitments.

Legal systems recognize this, and allow for the *de jure* variation of contractual commitments. In the case of a BIT, the investor is fully entitled to waive or abrogate his right to utilize the dispute resolution mechanisms as embodied in the BIT. This is the case where an investor has entered into a subsequent contract with a host state, with the contract stipulating its own *exclusive* dispute resolution mechanisms, which are at odds with the dispute resolution mechanisms of the BIT. *Lex posterior derogat priori.*

This also comports with deontological notions of fairness. A strict, formalistic divide between a treaty and contract claim cannot hold in the case of umbrella clauses, where a breach of an underlying contract is essential to a finding of a breach of treaty. An investor ought to be held to his bargain. Allowing the investor to now reprobate on the very contract upon which he is ultimately alleging breach would be substantively unfair. Further, rational parties would insist on a *quid pro quo*: a deleterious modification of an investor’s BIT right to sue is more often than not offset by a corresponding benefit, by for instance the host state paying a higher contract price.
One could object on the basis that, absent an explicit disavowal (in either the BIT[^37] or the contract) of an investor’s right to sue under the mechanisms of the BIT, arbitral tribunals should continue to adjudicate on the issue of contractual breach.[^38] This is true in the case of a BIT per se.[^39] However, in the context of a contract, such explicit language - although dispositive - should not be necessary. The central enquiry should be into whether the parties willed for the forum selection clause to be exclusive or not. An exclusive clause, by definition, excludes adjudication in non-specified forums. Requiring an explicit avowal on top of the forum selection clause would logically entail that the arbitral tribunal has construed the forum selection clause, standing alone, to be non-exclusive. To that extent, *SGS v. Paraguay* and *Aguas del Tunari SA v. Bolivia*[^40], which required explicit language repudiating the BIT right to sue, were wrongly decided. In *Paraguay*, the tribunal did not even reach the question of whether the forum selection clause[^41] was exclusive or non-exclusive. The tribunal also relied on an unduly formalistic divide between treaty and contract obligations, and ostensibly held that (exclusive) forum selection clauses cease to be “exclusive” because contract and treaty claims both “coexist” in the sense that umbrella clause remedies are “self-

[^37]: For instance, Agreement Concerning the Reciprocal Encouragement and Protection of Investments Art 8, Belgium and Luxemborg-Malta, Mar. 5, 1987 subjects the exercise of BIT mechanisms to the exhaustion of local remedies: “[w]here a dispute arises ... relating to a matter with respect to which the latter has undertaken an obligation in favour of the other Contracting Party under this Agreement, such a dispute shall in the first instance be dealt with in pursuit of local remedies, unless some other method, including arbitration, has been agreed between the investor and the Contracting Party.”


[^39]: *Id.*

[^40]: *Id.*

[^41]: Article 9 of the contract states that “[a]ny conflict, controversy or claim deriving from or in connection with this Agreement, breach, termination or invalidity, shall be submitted to the Courts of the City of Asunción under the Law of Paraguay.”
standing”. I have already shown this to be a fallacy in the context of umbrella clauses, where the treaty claim is parasitic on an underlying contractual claim. Because of this, the tribunal held that it had jurisdiction to adjudicate on umbrella clause claims that were premised on breaches of contract, and also did not stay proceedings. The plain language of the clause was strongly couched in mandatory terms, and should have been sufficient to ground a finding that the clause was meant to be exclusive. It was also highly inconsistent for the tribunal to insist on a plain language reading of the umbrella clause, and yet at the same time disregard a plain language reading of the forum selection clause.

There are two further potential objections to this which center around the non-derogability of the right to sue. First, one could argue that rights conferred by a treaty - between two states on the plane of public international law – cannot be modified by a private investor, who does not act on the public international law plane, and as such has no legal capacity to bargain away his rights. This objection is unpersuasive. The raison d’être of BITs is the promotion of foreign investment via the adjudication of claims in a neutral tribunal. The very act of suing in an arbitral tribunal, based on the violation of substantive rights controlled by public international law, is proof that such investors do have legal capacity (at least with respect to investment disputes) on the plane of public international law. To insist on a strict notion of international legal capacity being the exclusive province of states would simply be a legal fiction that has ceased to correspond with reality, where there has been an

42 At [181]
43 See supra, note 41
increasing breakdown in the classical view of international legal personality.\textsuperscript{44} If one has international legal personality to sue, one surely also has a corresponding power to modify one’s right of suit.

Second, one could argue that parties simply lack the power to “oust” the jurisdiction of a tribunal with otherwise proper jurisdiction.\textsuperscript{45} \textit{SGS v. Paraguay} held that “a [t]ribunal, faced with a claim and having validly held that it had jurisdiction [is] obliged to consider and decide it”;\textsuperscript{46} a decision to decline jurisdiction “would place the Tribunal at risk of failing to carry out its mandate under the treaty and the ICSID Convention”.\textsuperscript{47}

With respect, the tribunal in \textit{SGS v. Paraguay} identified a false dichotomy between a finding of no jurisdiction, and an inexorable obligation to decide the dispute where there is a finding of jurisdiction. There is a crucial difference between a tribunal which, having been seized of a particular dispute, then goes on to \textit{decline} to exercise jurisdiction via a stay of proceedings, and a tribunal which finds that it has no jurisdiction to begin with. Doctrinally, where proceedings have been stayed, there is no true ouster to speak of. Thus, a tribunal is not inexorably bound to decide a dispute, even where it has decided that it does have jurisdiction.

The practical effects differ as well. A stay can, in theory, be lifted after a period of time; a finding of no jurisdiction means that, for that particular

\textsuperscript{44} Another example would be international human rights tribunals, which confer on individuals rights to sue their home states for alleged human rights violations.
\textsuperscript{45} See [154] of \textit{SGS v. Philippines}
\textsuperscript{46} At [171]
\textsuperscript{47} At [172]
tribunal, it has no power to decide the dispute whatsoever. In rare cases where the stipulated contractual forum is, due to unforeseeable reasons like war or revolution, unable to adjudicate on the dispute after the stay, the stipulated BIT forum will be able to step into the breach. On balance, a stay is preferable to a finding of no jurisdiction for both doctrinal and instrumental reasons.

Further, regardless of whether there is a finding of no jurisdiction or a stay of proceedings, Paraguay’s line of criticism is only applicable to publically constituted judicial systems with mandatory jurisdiction over certain persons and/or subject matters. In a system of dispute resolution which is premised on the will of the parties – viz., the investor-state system of international arbitration – the will of the parties should trump considerations of institutional mandate. Permitting investors to contractually waive or alter their rights to the BIT process increases efficiency and convenience for both investors and host states alike. Pacta sunt servada: an agreement to modify an earlier agreement going to jurisdiction – even where this results in a finding of no jurisdiction or a stay – must be kept. The parties ought to have the capacity to revoke what they have willed. After all, the act of revocation is also an exercise of the will.

D. Conclusion

The SGS v. Philippines line of cases was correct in interpreting umbrella clauses widely: a breach of contract, via the umbrella clause, is also a breach
of treaty. This also follows from the will theory of contract, where it was pointed out that certain promises are legally enforceable – whether at the municipal or international level – precisely because the promisor has willed to be so bound.

SGS v. Philippines was also correct in staying the proceedings pending adjudication on the underlying breach of contract by the contractually specified forum. An investor should not be allowed reprobate on the very contract that he is relying on to show a breach of treaty. Contrariwise, SGS v. Paraguay, in adjudicating on the underlying breach of contract, allowed the investor to evade his willingly assumed contractual obligations, and was wrongly decided.