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ORIGIN, EVOLUTION AND PRESENT SIGNIFICANCE OF UMBRELLA CLAUSE IN INTERNATIONAL INVESTMENT PROTECTION LAW: DISTINCTION BETWEEN TREATY-BASED CLAIMS AND PURELY CONTRACTUAL CLAIMS.



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I. ABSTRACT

In the realm of international investment protection law, the umbrella clause stands as an enigmatic and pivotal component within the intricate tapestry of bilateral and multilateral, treaties. It's historic origin, evolutionary trajectory, and contemporary significance offer an insightful window into the dynamics landscape of Investor –state dispute resolution. The focal point of this research paper is to unravel the multifaceted nature of the umbrella clause, with a particular emphasis on distinguishing between treaty–based claims and purely contractual claims. By delving into the past, comprehending its metamorphosis, and elucidating its current import, this study endeavours to shed light on a crucial aspect of International Investment law that has far–reaching implications for states, investors, and the arbitration community.

II. INTRODUCTION

Umbrella clause is a cornerstone of the international investment law, bearing substantial implications for the resolution of disputes between foreign investors and host states. Also referred as “umbrella commitment” or “umbrella provision,” is a contractual provision commonly incorporated into bilateral Investment treaties (BITs) and other international agreements. As its core, this clause serves to elevate commitments and obligations undertaken

by the host states with foreign investors to the status of treaty obligations.¹ By doing so, it affords these commitments the same level of protection and enforceability as treaty-based rights. The precise wording of treaty may differ from one to another.

This research paper embarks on a comprehensive investigation of the umbrella clause within the context of international investment protection law with a particular emphasis on differentiating between treaty-based claim and purely contractual claim. The evolution and present significance of this clause is examined in context of foreign investment, taking not account the complicated interplay between international treaties and private contract. The paper's core research question is: How has umbrella clause evolved overtime, what is its current relevance in distinguishing between treaty-based claims and purely contractual claims in International Investment Dispute? This inquiry is approached through various studies about, its detailed interpretation by the tribunals, and its implications for investment arbitration.

The research methodology deployed for this study is multifaceted. It commences with an extensive review of relevant international investment treaties, arbitration case laws, and academic literature. Moreover, a comparative analysis of landmark investment arbitration cases is conducted to elucidate the various interpretations and applications of the Umbrella Clause. In addressing the research paper, the author seeks to provide novel insights into potential solutions for mitigating the ambiguities surrounding Umbrella clause. By clarifying the distinction between treaty-based and contractual claims, it aims to offer practical guidance to investors, states, and legal acumen navigating the intricate terrain of investment arbitration. Ultimately this study seeks to enhance the fairness, consistency, and effectiveness of international investment law by addressing the complexities inherent in the Umbrella Clause's application.

III. LITERATURE RIVEW

Historic Origins of the Umbrella Clause.

It is with the development of international investment protection law, where the historic origin of umbrella clause is deeply rooted. Historically, investment treaties were primarily concerned with the state-to-state relations, and investors relied on diplomatic protection. However, the concept of providing direct protection to foreign investors began to take shape during the mid-20th century. This evolution can be traced back to post-World War II era when the need to encourage foreign investment led to the negotiation of bilateral investment treaty (BIT) and

¹ Doizer, R., & Schreuer, C. (2008). Principles of International Investment Law. Oxford University Press

other international agreements.²

One of the earliest references to the umbrella clause can be found in the 1959 Germany-Pakistan BIT, which stated that disputes under the treaty should be submitted to arbitration “in accordance with the applicable rule of international law.”³ This vague formulation laid down the foundation of subsequent variation of the umbrella clause, which has evolved over time to encompass a broader range of commitments undertaken by the host states towards foreign investors.

Evolution of Umbrella Clause over time.

The evolution of the umbrella clause reflects the changing landscape of the international investment law of international investment law. Early interpretations of the clause were relatively narrow, focusing on contractual commitments explicitly provided for in the treaty. However, as investment treaty proliferated, and disputes involving contractual commitments increased, tribunals began to adopt broader interpretations of the umbrella clause.

Concepts of Treaty-based Claims and Purely Contractual Claims.

Distinguishing between treaty-based claims and purely contractual claims within the context of umbrella clause has been a central issue in the investment arbitration. Treaty based claims typically involve violations of specific treaty provisions such as expropriation for fair and equitable treatment. These claims rely on the investors status as a protected party under an investment treaty.

In contrast, purely contractual claims arise from investment contracts between the investor and the host state. These claims may not necessarily involve treaty provisions explicitly, but rather contractual obligations undertaken by the host state. The distinction between these two types of claims has significant implications for the rights and remedies available to investors and states.

Previous research and debate in the field.

The distinction between treaty-based claim and purely contractual claim has been a topic of debate among legal scholars and practitioners. Previous research explored the implications of the Salini decision and its impact on the Scope of umbrella clause. Some argue that the broad interpretation of the umbrella clause jeopardises state sovereignty, as it allows investors to

² Doizer, R., & Schreuer, C. (2008). Principles of International Investment Law. Oxford University Press

³ Germany-Pakistan Bilateral Investment Treaty, Art. VII (1959)

bypass treaty provisions explicitly negotiated between the states.⁴ Other contended that the interpretation is necessary to ensure adequate protection of investors and promote foreign direct investments.⁵

Furthermore, Scholars have examined the challenges posed by this distinction in practice, emphasising the need for clarity in Investment treaties and arbitration proceedings. Debates continue to revolve around how to strike a balance between protecting investor's legitimate expectations and preserving the sovereign regulatory authority of the host states.⁶

IV. INVESTMENT ARBITRATION CASES: CHANGES IN INTERPRETATION AND JURISPRUDENCE OVER TIME OF UMBRELLA CLAUSE.

The Salini doctrine ushered in a new era of interpretation and jurisprudence regarding the umbrella clause. Arbitral tribunals increasingly adopted a broader view, extending the scope of the clause to encompass wider range of commitments made by host states.⁷ This shift has blurred the line between treaty-based claims and purely contractual claims, as the distinction between them became less clear-cut.

However, it is important to note that not all cases have embraced the expansive interpretation of the umbrella clause as seen in Salini. Some tribunals remained more circumspect, emphasising the need for a direct nexus between breach of a contractual commitment and a treaty violation.⁸ As a result, the Interpretation of umbrella clause continues to be a subject of debate and contention in investment arbitration. Subsequent cases have grappled with the implications of the Salini decision and the scope of the Umbrella Clause. In *Siemens v. Argentina* (ICSID Case No. ARB/02/8) case further contributed to the evolution of umbrella clause jurisprudence. In this case, the tribunal grappled with the implications of the Salini doctrine and adopted a more cautious approach. It emphasised the need for a “legally significant connection” between the breach of a contractual commitment and a treaty violation for the umbrella clause to apply.⁹ This decision reflects the ongoing debates and differential interpretations of the Umbrella clause within the investment arbitration community. It also

⁴ Muchlinski, P. (2008). *Multinational Enterprises and the Law*. Oxford University Press

⁵ Schreuer, C. (2001). *Umbrella Clause in Recent Investment Treaties – A Comment*. *ICSID Review – Foreign Investment Law Journal*, 16(1), 1-16.

⁶ Schill, S.W. (2013). *The Multilateralization of International Investment Law*. Cambridge University Press.

⁷ Ibid

⁸ *Technicas Meldoambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2 (May 29,2003)

⁹ *Siemens v. Argentina*, ICSID Case No. ARB/01/13 (August 6,2003)

underscored a complexity of distinguishing between treaty-based claims and purely contractual claims.

The divergences in interpretation of umbrella clause were further exemplified in *SGS v. Pakistan* (ICSID Case No. ARB/01/13). This decision highlighted the ongoing tension in investment arbitration regarding the scope and application of the umbrella clause. In this case, the tribunal adopted a broader interpretation, aligning with the Salini doctrine. It held that the umbrella clause covers contractual commitments that do not necessarily have an explicit treaty reference, emphasising the overarching objective of ensuring protection for investor.¹⁰ Further the decision of *SGS v. Philippines* (ICSID Case No. ARB/02/6)¹¹ contradicted tribunals decision of *SGS v. Pakistan*. It was different as tribunal recognised the border between the concept of purely contractual claim and treaty claim. A diverse approach was adopted accepting jurisdiction and rejecting merits. However, a mid way approach was adopted, complexities with respect to umbrella clause increased.

The evolution of the umbrella clause's interpretation and jurisprudence in investment arbitration cases reflects the complexities and nuances inherent in international investment protection law. Landmark cases like Salini, Siemens, and SGS have contributed to shifts in interpretation, moving from more restrictive approaches to broader interpretations of the clause. These changes have far-reaching implications for the rights and remedies available to foreign investors and the sovereignty of host states. They underscore the ongoing debates and challenges surrounding the umbrella clause, making it a central issue in contemporary investment arbitration proceedings.

V. DISTINGUISHING TREATY-BASED CLAIMS AND PURELY CONTRACTUAL CLAIMS.

The umbrella clause within international investment protection law plays a pivotal role in elevating commitments and obligations made by host states to foreign investors to the status of treaty obligations. Distinguishing between treaty-based claims and purely contractual claim within the framework of umbrella clause involves understanding their conceptual differences, legal implications, and obligations. This distinction is significant in determining the rights and remedies available to investors and states in investment dispute and to understand the scope and limitations of umbrella clause.

¹⁰ *SGS v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13 (August 6, 2003)

¹¹ *SGS v. Republic of Philippine*, ICSID Case No. ARB/02/6 (2004)

Conceptual differences between the two types of claims.

Treaty-based claims typically revolve around the violation of specific treaty provisions. Investors who assert treaty-based claims rely on their status as protected parties under an investment treaty. These claims are rooted in the breaches of treaty obligations concerning fair and equitable treatment, protection from expropriation without compensation, or other treaty-based protections.

Purely contractual claims, on the other hand, arise from investment contracts between the investor and the host state. These claims may not necessarily involve treaty claims explicitly. Instead, they are grounded in the contractual obligations undertaken by the host state in agreements such as concession contract, joint venture agreements, or other investment-related contracts. Purely contractual claims derive from the breach of these contractual commitments, regardless of whether they directly correspond to treaty provisions.

Legal Implications and obligations associated with Treaty-based Claims.

Treaty-based claims carry legal implications and obligations. When investors assert treaty-based claims, they trigger the protections and obligations outlined in investment treaty itself. This includes the host states commitment to provide fair and equitable treatment, protection against expropriation without compensation, and ensure full safety and security for investments. Moreover, treaty-based claims often grant investor access to investor state dispute settlement mechanism, such as arbitration under international centre for settlement of investment dispute (ICSID) or ad hoc arbitration under The United Nations Commission on International Trade Law (UNCITRAL) rules. These remedies provide investors with a direct avenue to seek remedies for treaty violation.

However, being different contractual claims can be elevated to treaty-based claims. Therefore, a contractual claim can be a treaty-based claim, but all contractual claims cannot be said as treaty-based claim. Let us see this Doctrine of Elevation in detail.

VI. THE DOCTRINE OF ELEVATION

The Doctrine of elevation represents significant legal principle. This doctrine pertains to the process by which purely contractual claim, grounded in agreements between investors and host states, are elevated to the status of treaty-based claims, thereby affording them the protection and mechanisms outlined in investment treaties. To elucidate the doctrine, it is important to explore how and on what grounds contractual claims are elevated to treaty-based claims.

Elevation of contractual claims to treaty-based claims.

Under the umbrella clause, this elevation occurs when the host state has undertaken contractual commitments that effectively incorporate treaty obligations. The key criteria which evolved after various decisions in the cases discussed above is the connection between the contractual commitment and the relevant treaty provisions. When this connection is established, contractual claims are elevated, transforming them into treaty-based claims.¹²

Grounds for elevation.

1. **Incorporation of Treaty Obligations:** One ground for elevation is the incorporation of treaty obligations within the contractual commitments made by the host state. This can occur when the language of the contractual commitment mirrors the language of the relevant treaty provisions. If the host state's contractual undertaking is analogous to treaty obligations, it can lead to the elevation of contractual claims.
2. **Direct access to treaty provisions:** Another ground for elevation is the establishment of direct Nexus between the breach of contractual commitment and the violation of specific treaty provisions. If the breach of the contractual commitment effectively amounts to a breach of treaty-based protections, the claims may be elevated to treaty-based claims.

VII. CONTEMPORARY SIGNIFICANCE OF THE UMBRELLA CLAUSE

The contemporary significance of the umbrella clause in international investment protection law is marked by recent developments, challenges in investment arbitration, ongoing debates, and practical implications for states, investors, and arbitrators.

Recent developments and challenges in investment Arbitration.

In recent years, investment arbitration has witnessed a surge in cases involving the umbrella clause. This surge reflects both the increasing complexity of investment disputes and evolving interpretation of the clause.

One significant recent development is the proliferation of investment treaties and trade agreements that include umbrella clauses. These clauses can vary significantly in language and scope, contributing to diverse interpretations and challenges for investors and host states.¹³

Furthermore, the increasing use of double-tiered dispute resolution mechanisms, such as the

¹² SGS v. Republic of Philippines, ICSID Case No. ARB/02/6 (2004)

¹³ Doizer, R., & Schreuer, C. (2008). Principles of International Investment Law. Oxford University Press

exhaustion of local remedies, has introduced additional complexities in applying the Umbrella Clause. Tribunals must navigate the interplay between these mechanisms and the scope of the clause.

Ongoing Debates and Controversies surrounding the clause.

The umbrella clause remains a subject of ongoing debates and controversies within the realm of umbrella clause. Key areas of contention include:

1. **Scope of the Umbrella Clause:** One Of the primary debates concerns the scope of umbrella clause. while some tribunals adopt a broad interpretation, Other adhere to a more restrictive approach, emphasising a direct Nexus with treaty obligation.¹⁴
2. **Overlap with other Treaty Provisions:** The interaction between the umbrella clause and other treaty provisions, such as fair and equitable treatment or expropriation clause, continues to generate disputes. tribunals grapple with determining whether claims should be brought under the umbrella clause or other treaty provisions.
3. **Arbitration Precedents:** The weight of arbitrary precedent, particularly cases like *Salini v. Morocco*, influences how tribunals interpret and apply the umbrella clause. However, tribunals remain divided on extent to which they should follow or depart from past decisions.¹⁵

Practical Implications for States, Investors, and Arbitrators.

The contemporary significance of the Umbrella Clause has practical implications for various stakeholder.

1. **State:** Host States must carefully consider the scope and language of the umbrella clause in their investment treaties. This includes negotiating clear and unambiguous language to define the obligations subject to the clause.
2. **Investor:** Foreign Investors need to assess the protection offered by the Umbrella Clause in potential investment destinations. They must also be prepared to navigate the complexities of distinguishing between treaty-based and contractual claims.
3. **Arbitrators:** Arbitrators play a pivotal role in interpreting and applying the umbrella clause. Their decisions impact the rights and obligations of the state and investors. consistency in decision making and adherence to established jurisprudence remain

¹⁴ Siemens v. Argentina, ICSID Case No. ARB/02/8 (September 30, 2007)

¹⁵ Salini Costruttori S.p.A, and Italstrade S.p.A. v. The Kingdom of Morocco, ICSID CASE no. ARB/00/4 (July23, 2001)

critical challenges for the arbitrators.

VIII. CONCLUSION: SOLUTIONS & RECOMMENDATIONS.

The umbrella clause, a critical component of international investment protection law, has undergone a remarkable evolution, raising vital questions about its interpretation and implications. As this paper has elucidated the distinctions between treaty-based claims and purely contractual claims under the umbrella clause have significant implications for states, investors, and arbitrators alike. In conclusion, this section offers solutions and recommendations to address ambiguities in the umbrella clause, and hence clarity in treaty drafting, and a strike balance between state sovereignty and investor protection.

Addressing ambiguities in the umbrella clause

1. Establishing Clear Definition: To mitigate ambiguities surrounding the umbrella clause, investment treaties should include clear and precise definitions of key terms, such as “commitments” and “obligations”. Providing specific language can help States and investors understand the scope and limitations of the clause.¹⁶
2. Uniform Interpretation: Encouraging a uniform interpretation of the umbrella clause by arbitral tribunals is vital. The investment arbitration community should foster consistency in decisions, offering clear guidance to states and investors navigating claims under the clause.

Enhancing Clarity in Treaty Drafting

1. Model BITs: The development of model BITs can aid in standardising the language and provisions of the umbrella clause. These model treaties can serve as templates for states when negotiating new investment agreements, promoting consistency in the treatment of the clause.¹⁷
2. Consultation and Expertise: States should seek the input of legal experts and practitioners in investment law during the treaty drafting process. Expert guidance can help ensure that the language of the umbrella clause is precise, comprehensive, and aligned with evolving jurisprudence.

¹⁶ Schreuer, C. (2001). Umbrella Clause in Recent Investment Treaties – A Comment. *ICSID Review – Foreign Investment Law Journal*, 16(1), 1-16.

¹⁷ United Nations Conference on Trade and Development (UNCTAD). (2012). *UNCTAD’s Investment Policy Framework for Sustainable Development*. United Nations.

In conclusion, the umbrella clause remains a dynamic and critical element of international investment protection law. resolving ambiguities, enhancing clarity in treaty drafting, and balancing states sovereignty with investor protection are essential objectives in ensuring the continued efficiency of the clause. achieving this balance requires collaboration of among states, legal experts, and the investment arbitration community to promote a coherent and equitable international investment regime.

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