

# Treaty and Contract in Investment Arbitration

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## ABSTRACT

*This article addresses one of the most controversial issues in international investment law: the relationship between BIT claims and contractual claims. The author proposes an integrationist approach, which seeks to reconcile the opposing views and jurisprudence on the subject. This approach is developed within the framework of international law, from which the author distils five relevant principles. The arbitral and academic disagreement on the topic is discussed in the context of three different fields: contractual claims and counter-claims, umbrella clauses, and the role of legitimate expectations in the application of the fair and equitable treatment standard.*

A Subject and a Sovereign are clean different things.  
Charles I, speech on the scaffold, 30 January 1649<sup>1</sup>

## I. INTRODUCTION

NO ISSUE in the field of investment arbitration is more fundamental, or more disputed, than the distinction between treaty and contract.<sup>2</sup> There is a struggle between those who believe bilateral investment treaty (BIT) claims should be insulated from contractual claims and those who want to relate the two. That struggle has led to a divided jurisprudence and – as often happens when jurists are divided – to a tendency to caricature opposing positions. In these circumstances, both time and further reflection are necessary before any

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<sup>1</sup> ‘King Charls his Speech made upon the Scaffold at Whitehall-Gate immediately before his Execution, on Tuesday the 30 of Jan 1648. With a Relation of the manner of his going to Execution’ in *The Trial and Execution of King Charles I: Facsimiles of the Contemporary Official Accounts Contained in the Charge of the Commons of England Against Charls Stuart, King Charls His Tryal, King Charls His Speech Made Upon the Scaffold* (Scholar Press Ltd, Leeds, reprinted 1966), (6).

<sup>2</sup> See e.g., Z. Douglas, ‘The Hybrid Foundations of Investment Treaty Arbitration’ in (2003) 74 *BITL* 151; C. McLachlan *et al.*, *International Investment Arbitration: Substantive Principles* (OUP, 2007), p. 90, paras. 4.33–4.34, p.127, paras. 4.149–4.151.

consensus can emerge, and the views of one proponent in the debate are no more likely to achieve immediate acceptance than the views of any other. What I will try to do here, however, is to set out the foundations in general international law for the approach I prefer. I am reluctant to attach any label to it, but for convenience I will call it the integrationist approach, since it attempts a reconciliation between two propositions both generally agreed but which seem to be in perpetual tension with each other in this field: on the one hand, the proposition that a host state cannot rely on its own law as a justification for failing to comply with its international obligations, including those obligations arising under treaties for the protection of foreign investment; on the other, the proposition that an investment is, in the very first place and by definition, a transaction occurring in the host state and governed by its laws.

Now, of course, there is only one world, however we may divide it conceptually: there is no such *place* as the ‘international plane’. In the modern period, investment contracts have always coexisted with international law standards for the protection of investments, so this tension is not novel, as students of the old mixed arbitral tribunal decisions will not need reminding. International law resolved that tension in two ways, thereby underpinning the dominant dualist theory about the relations between international and national law. The first was by strictly applying the exhaustion of local remedies rule: national law issues had to be resolved first before the competent national courts.<sup>3</sup> The second was by way of the rule that for an international tribunal, national law is a pure question of fact,<sup>4</sup> a fact for the most part determined by the very resort to local remedies which international law mandated in the field of diplomatic protection. Thus, there was a conceptual separation secured by a temporal separation: international law covered the distinct field of interstate claims premised upon the failure to resolve the underlying individual dispute first through national courts and national law.

But in the field of investment arbitration, neither of these rules applies. First, there is no requirement of exhaustion of local remedies prior to commencing investment arbitration, unless, exceptionally, that requirement has been expressly maintained.<sup>5</sup> Secondly, the standard applicable law clause in BITs (however it may be formulated) mandates and may even require the tribunal to apply the law of the host state alongside international law. Faced with article 42 of the ICSID

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<sup>3</sup> ILC (Dugard, Special Rapporteur), ‘Draft Articles on Diplomatic Protection with Commentaries’ in *Report of the International Law Commission on the Work of its Fifty-eighth Session*, 1 May–9 June, 3 July–11 August 2006 (UN Doc A/61/10). Part 3 of the Draft Articles deals with ‘Local Remedies’. Subject to the exceptions in Art. 15, Art. 14(1) provides that a state may not present an international claim in respect of an injury to a national (or a stateless person or refugee as provided for under Art. 8) before the injured person has exhausted all local remedies.

<sup>4</sup> I. Brownlie, *Principles of Public International Law* (6th edn, OUP, Oxford, 2003), pp. 38–40.

<sup>5</sup> C. Schreuer, *The ICSID Convention: a Commentary* (CUP, Cambridge, 2001), pp. 388–396; McLachlan *et al.*, *supra* n. 2 at p.128, para. 4.152. This does not mean that the existence of an adequate local remedy may not be relevant to the merits of a treaty claim, but that is another matter.

Convention<sup>6</sup> or some equivalent provision in a BIT, it cannot be argued that the law of the host state is a mere matter of fact. It is true that tribunals have to be informed, by expert evidence or otherwise, of the content of host state law with which they may not be familiar.<sup>7</sup> It is also true that a treaty provision which mandates the application of the law of a state is presumed to do so subject to the international law conflicts rule, that international law prevails over national law in case of inconsistency. But that is a rule of conflict of *laws*: it does not treat national law as a mere matter of fact. And in the large majority of cases, where there is no inconsistency between international law and the law of the host state, the two laws have to be applied in parallel.

Before I turn to some ways in which this tension has been addressed, a preliminary remark is called for. According to an influential view of the international arbitral function, it is an illusion to think that there is a right or correct method of resolving such issues as these. Arbitrators are not judges; there is no method of ensuring ‘correct’ decisions, and there will be unresolvable disagreements at the general level between arbitrators depending on their own legal traditions and approaches. The requirement that arbitrators give reasons (imposed, for example, by Articles 48(3) and 52(1)(e) of the ICSID Convention) is a *process* requirement. It is intended to ensure that the tribunal does its job and does not decide in an arbitrary manner; it is not intended to enable substantive review of the reasons for deciding the merits of the disputes submitted to arbitration. According to this pluralist view, the well-known disagreement in the two *SGS* cases over the umbrella clause<sup>8</sup> should not be allowed to mask the fact that the two tribunals reached similar functional conclusions, both allowing contract claims to proceed before national-level forums (in one case domestic arbitration, in another, national courts) where the parties to the investment contracts had agreed on the exclusive jurisdiction of those forums. On this view it is a mistake to look for a *jurisprudence constante* such as might characterise a unified jurisdiction with a unitary system of law. Rather the search must be for *patterns* of decisions and for an acceptable spectrum of views.

Evidently legal theorists have debated this issue for ages, and it must be added to the lengthening list of points which in the confines of a lecture (if not a lifetime) I am not going to be able to settle. But, with all due deference to the plural character of arbitration, I must say that I find the current level of dissensus on core questions disturbing; the carpet looks very much as if different people have started from different ends without many common threads – a crazy quilt rather than a Persian rug. At any rate I think we should strive towards a closer

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<sup>6</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Washington, 18 March 1965, 575 UNTS 159.

<sup>7</sup> Expert evidence of international law is also tendered before such tribunals: whether or not this is desirable, the evidence is not inadmissible.

<sup>8</sup> *SGS Société Générale de Surveillance SA v. Islamic Republic of Pakistan*, ICSID Case no. ARB/01/13, Decision on Objections to Jurisdiction, 6 August 2003, 8 ICSID Rep. 406 (hereafter *SGS v. Pakistan*); *SGS Société Générale de Surveillance SA v. Republic of the Philippines*, ICSID Case no. ARB/02/6, Decision on Objections to Jurisdiction, 29 January 2004, 8 ICSID Rep. 515 (hereafter *SGS v. Philippines*).

agreement on such questions as the effect of the standard umbrella clause or the role of legitimate expectations, rather than rejoicing in a complete system of *laissez-faire*.

## II. THE INTERNATIONAL LAW FRAMEWORK

I said earlier that I hoped to set out the foundations in general international law for the integrationist approach. Within the time available I would make five points.

The first is that there is no *a priori* limitation on the scope or content of treaty obligations, even those concerning what would otherwise be internal affairs. There is no *a priori* definition of what is or is not international, nor is there any presumption of the restrictive interpretation of treaties. We find authority for this in *The Wimbledon*, the first contentious case to come before the first permanent international court.<sup>9</sup> The issue was whether the guarantee of freedom of transit through the Kiel Canal under Article 380 of the Treaty of Versailles of 1919,<sup>10</sup> a guarantee which extended to ships of ‘all nations at peace with Germany’, required Germany to allow the transit through the canal of a ship carrying munitions to Poland, then at war with Russia. It was argued that a treaty provision should be restrictively interpreted because otherwise it would amount to an infringement on Germany’s sovereignty. The court, in a passage echoed many times since:

decline[d] to see in the conclusion of any Treaty by which a State ... undertakes to perform ... a particular act an abandonment of its sovereignty. No doubt any convention creating an obligation of this kind places a restriction upon the exercise of the sovereign rights of the State, in the sense that it requires them to be exercised in a certain way. But the right of entering into international engagements is an attribute of State sovereignty.<sup>11</sup>

Thus, an argument from sovereignty was evaded by an appeal to sovereignty: if states could not enter into binding international obligations, they would lack an attribute of statehood.

I should observe that the German argument in that case had considerable weight because it was supported by another basic rule, that the rights of third states are unaffected by treaties to which they are not party. Germany relied on its obligation of neutrality vis-à-vis Russia, not a party to the Treaty of Versailles, in support of a restrictive interpretation of the transit regime for the Kiel Canal under that treaty – but to no avail. By contrast in the investment context, the rights and obligations in question are those of the host state, by definition a party to the treaty. No third state problem arises.

<sup>9</sup> (1923) PCIJ Ser. A No. 1.

<sup>10</sup> 225 CTS 188.

<sup>11</sup> (1923) PCIJ Ser. A No. 1, 25.

This gives rise to the second general principle, the principle that treaty language is presumed to have its natural and ordinary meaning in its context. It is stated as the general rule in Article 31(1) of the Vienna Convention on the Law of Treaties of 1969.<sup>12</sup> A corollary is the principle of *effet utile*: the words of a substantive treaty provision should be given some rather than no effect. A further corollary is that each investment treaty has to be interpreted in its own terms and in its own right. There is no such thing as *the* umbrella clause; rather, there are umbrella clauses. No doubt where these are in identical or nearly identical terms they should be given the same or similar meaning; but where different language is used compared with existing standard formulas, it may be presumed that some difference in meaning was intended.

The next three principles are drawn from the law of state responsibility. Normally, the responsibility of states in the field of investment treaty arbitration is a species of state responsibility, *i.e.* the responsibility of a state party for breach of the substantive international obligations created by the investment treaty. For this purpose it makes no difference whether these obligations are owed to the other state party to the treaty or directly to the investor. The former view was adopted by the NAFTA Tribunal in the *Loewen* case, when it said that:

233. ... Rights of action under private law arise from personal obligations (albeit they may be owed by or to a State) brought into existence by domestic law and enforceable through domestic tribunals and courts. NAFTA claims have a quite different character, stemming from a corner of public international law in which, by treaty, the power of States under that law to take international measures for the correction of wrongs done to its nationals has been replaced by an ad hoc definition of certain kinds of wrong, coupled with specialist means of compensation. These means are both distinct from and exclusive of the remedies for wrongful acts under private law: see Articles 1121, 1131, 2021 and 2022. It is true that some aspects of the resolution of disputes arising in relation to private international commerce are imported into the NAFTA system via Article 1120.1(c), and that the handling of disputes within that system by professionals experienced in the handling of major international arbitrations has tended in practice to make a NAFTA arbitration look like the more familiar kind of process. But this apparent resemblance is misleading. *The two forms of process, and the rights which they enforce, have nothing in common. There is no warrant for transferring rules derived from private law into a field of international law where claimants are permitted for convenience to enforce what are in origin the rights of Party states.*<sup>13</sup>

This is a fascinating issue, but in the majority of cases it will make no difference to the result. Even if the primary obligation is owed only to the other state party to the BIT and is defeasable on an interstate basis, the responsibility *invoked* by the investor in investor-state arbitration is the responsibility of the state and it is governed, as declaratory of international law, by Part 1 of the ILC Articles on Responsibility of States for Internationally Wrongful Acts.<sup>14</sup> In the

<sup>12</sup> Vienna Convention on the Law of Treaties, Vienna, 23 May 1969, 1155 UNTS 331.

<sup>13</sup> *The Loewen Group Inc. and Raymond L. Loewen v. United States*, ICSID Case no. ARB(AF)/98/3, Award, 26 June 2003, 7 ICSID Rep. 442 (emphasis added).

<sup>14</sup> Hereafter 'ILC Articles'. These are appended to GA Res. 56/83, 14 December 2001; they and the ILC's commentaries are reprinted in J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (CUP, Cambridge, 2002).

words of Article 33(2) of the ILC Articles, in investment arbitration the investor, a person or entity other than a state, seeks to vindicate a ‘right, arising from the international responsibility of a State’, and it does so whether or not the primary obligation is owed to that person or entity.<sup>15</sup>

Within the field of Part I of the ILC Articles, the following propositions are relevant.

For state responsibility to arise, the conduct in question must be attributable to the host state under the rules set out in Articles 4 to 11 of the ILC Articles. Attribution is a legal operation by which the conduct of a range of domestic law entities is treated as conduct of an international law entity, the state. In some cases, as with Article 4 organs, all the conduct of such organs is attributable to the state, whether or not it is characterised as conduct *iure imperii* or *iure gestionis*. In other cases, as with separate entities exercising elements of governmental authority under Article 5, only certain conduct is so attributable. In principle attribution does not involve any piercing of the corporate veil, although that may be called for in specific cases. Nor does the process of attribution redefine the state in terms of its own internal law: who represents the state domestically may be different from who does so in international law.<sup>16</sup> I am reliably informed that there is no such entity as ‘Poland’ in Polish law – by contrast, much of twentieth century history concerned its existence and identity as a matter of international law. Thus, the mere fact that acts of separate entities may be attributable to the state in particular cases does not mean that the contracts of such entities are state contracts.

The fourth proposition, also drawn from the law of state responsibility, concerns breach. In general, a finding of a breach of international law does not depend on the characterisation of the conduct in question as ‘governmental’, or as involving the exercise of sovereign authority. There are only two questions: what is the state obliged to do or refrain from doing, and has it complied with that obligation? Unless the primary rule which is the source of the obligation requires it, there is no third question, how to characterise the breach. Still less is there any requirement to prove any particular motive, whether financial or ‘governmental’. That point is made in the ILC’s commentaries, on both Articles 4 and 12. Thus, the ILC said on Article 4:

It is irrelevant for the purposes of attribution that the conduct of a State organ may be classified as ‘commercial’ or ‘*acta iure gestionis*’. The breach by a State of a contract clearly does not as such entail a breach of international law. Something further is required before international law becomes relevant, e.g. a denial of justice by the courts of the State in proceedings brought by the other contracting party. But the entry into or breach of a contract by a State organ is nonetheless an act of the State for the purposes of article 4, and it may amount to an internationally wrongful act.<sup>17</sup>

<sup>15</sup> See ILC Art. 33(2) and commentary, para. 4, reprinted in Crawford, *supra* n. 14 at pp. 207–208.

<sup>16</sup> Cf. *Maritime Delimitation and Territorial Questions between Qatar and Bahrain*, Jurisdiction and Admissibility, Judgment, (1994) ICJ Rep. 112, paras. 28–29.

<sup>17</sup> See ILC, Commentary to Art. 4, para. 6, reprinted in Crawford, *supra* n. 14 at p. 96.

The irrelevance of the classification of the acts of state organs as *iure imperii* or *iure gestionis* was affirmed by all those members of the Sixth Committee who responded to a specific question on this issue from the Commission.<sup>18</sup>

Similarly in its commentary on Article 12, the basic article on breach, the ILC noted that:

International awards and decisions specifying the conditions for the existence of an internationally wrongful act speak of the breach of an international obligation without placing any restriction on the subject-matter of the obligation breached. Courts and tribunals have consistently affirmed the principle that there is no *a priori* limit to the subject matters on which States may assume international obligations ... [T]he breach by a State of an international obligation constitutes an internationally wrongful act, whatever the subject matter or content of the obligation breached, and whatever description may be given to the non-conforming conduct.<sup>19</sup>

To take an example, the refusal at one point by the United Kingdom to proceed with the Concorde project, as required by a bilateral treaty with France,<sup>20</sup> threatened a breach of that treaty, and it would have been irrelevant whether the British motive was to save money or protect the environment.<sup>21</sup>

The fifth principle is that of independent characterisation and is stated in Article 3 of the ILC Articles:

The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.

The relevance of this for our inquiry is explained in the commentary:

Especially in the fields of injury to aliens and their property and of human rights, the content and application of internal law will often be relevant to the question of international responsibility. In every case it will be seen on analysis that either the provisions of internal law are relevant as facts in applying the applicable international standard, or else that they are actually incorporated in some form, conditionally or unconditionally, into that standard.<sup>22</sup>

To summarise, state responsibility for breach of international law is distinct from the liability of a state for breach of its contracts. But there may be important overlaps: for example, a state may commit by treaty to comply with a contract, in which case its failure to do so is (subject to any circumstance precluding wrongfulness) also a breach of an international obligation. Responsibility for

<sup>18</sup> See Report of the ILC, 1998 A/53/10, para. 35.

<sup>19</sup> ILC, Commentary to Art. 12, paras. 9, 10, reprinted in Crawford, *supra* n. 14 at pp. 128–129.

<sup>20</sup> Agreement between the Government of the United Kingdom and the Government of the French Republic regarding the Development and Production of a Civil Supersonic Transport Aircraft, 29 November 1962, 453 UNTS 326.

<sup>21</sup> See C. Gardner, *British Aircraft Corporation: a History* (Batsford, London, 1981), ch. 36, esp. at pp. 270–271.

<sup>22</sup> ILC, Commentary to Art. 3, para. 7, reprinted in Crawford, *supra* n. 14 at p. 89.

breach of treaty is conceptually distinct from responsibility for breach of contract, but the latter may, depending on the context, entail or imply the former.

These five principles provide the necessary background to what is still the leading case on the contract/treaty distinction, the *Vivendi Annulment* decision. The claimants operated water and sewerage systems in Tucumán, a province of Argentina, pursuant to a contract with the first claimant, a locally-incorporated Vivendi affiliate, and Tucumán. The contract conferred exclusive jurisdiction on Tucumán's administrative tribunals for 'interpretation and application' of the contract.<sup>23</sup>

Following numerous disputes, both parties rescinded and claimed the other was in default. The claimants instituted ICSID arbitration on the basis of the 1991 France-Argentina BIT, alleging that its investor rights had been infringed by public health orders, mandatory service obligations and rate regulations. The tribunal held that the contract did not prevent the investor from proceeding against Argentina under the ICSID Convention on the basis of its alleged violation of the BIT. However, all the claims concerning the action of the Argentine province arose from disputes concerning the performance of the contract, and the claimant had agreed to submit those disputes exclusively to the jurisdiction of the Tucumán courts. As it was impossible to separate breaches of the contract by Tucumán from potential violations of the BIT, the claimant had first to bring proceedings before the administrative courts of Tucumán as provided for by the contract.<sup>24</sup>

The tribunal's award was partially annulled by an ad hoc Committee.<sup>25</sup> The Committee distinguished between determining whether there has been a breach of the BIT, which must be considered by reference to international law, and whether the contract has been breached, which must be determined by reference to the proper law of the contract (Tucumán law, in the present case):

As to the relation between breach of contract and breach of treaty ... [a] state may breach a treaty without breaching a contract, and vice versa ... In accordance with this general principle (which is undoubtedly declaratory of general international law), whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the [contract], by the proper law of the contract, in other words, the [municipal law].<sup>26</sup>

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<sup>23</sup> Concession Contract for Water and Sewage Service in the Province of Tucumán, 18 May 1995, art. 16.4 provided as follows: 'For purposes of interpretation and application of this Contract the parties submit themselves to the exclusive jurisdiction of the Contentious Administrative Tribunals of Tucumán'.

<sup>24</sup> *Compañía de Aguas del Aconquija SA and Compagnie Générale des Eaux/Vivendi Universal v. Argentine Republic*, ICSID Case no. ARB/97/3, Award, 21 November 2000, 5 ICSID Rep. 299.

<sup>25</sup> *Compañía de Aguas del Aconquija SA and Compagnie Générale des Eaux/Vivendi Universal v. Argentine Republic*, ICSID Case no. ARB/97/3, Decision on Annulment, 3 July 2002, 6 ICSID Rep. 340.

<sup>26</sup> *Ibid.* 365, paras. 95–96.



The tribunal ought not to have allowed Argentina to rely on the contract's exclusive jurisdiction clause to avoid the characterisation of its conduct as internationally unlawful under the BIT:

In a case where the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract ...<sup>27</sup>

On the other hand, where 'the fundamental basis of the claim' is a treaty laying down an independent standard by which the conduct of the parties is to be judged, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state or one of its subdivisions cannot operate as a bar to the application of the treaty standard. At most, it might be relevant – as municipal law will often be relevant – in assessing whether there has been a breach of the treaty ...<sup>28</sup>

It is one thing to exercise contractual jurisdiction ... and another to take into account the terms of a contract in determining whether there has been a breach of a distinct standard of international law ...<sup>29</sup>

Whether particular conduct involves a breach of a treaty is not determined by asking whether the conduct purportedly involves an exercise of contractual rights.<sup>30</sup>

By refusing to interpret the contract, the tribunal 'failed to decide whether or not the conduct in question amounted to a breach of the BIT':<sup>31</sup>

A treaty cause of action is not the same as a contractual cause of action; it requires a clear showing of conduct which is in the circumstances contrary to the relevant treaty standard. The availability of local courts ready and able to resolve specific issues independently may be a relevant circumstance in determining whether there has been a breach of international law ... But it is not dispositive, and it does not preclude an international tribunal from considering the merits of the dispute.<sup>32</sup>

The Committee held that the tribunal committed a manifest error of jurisdiction if, having upheld its jurisdiction over an admissible treaty claim, it declined to decide that claim.<sup>33</sup> (I note in parenthesis that a second tribunal upheld Vivendi's restated claim, awarding damages of US\$105,000,000.<sup>34</sup>)

*Vivendi Annulment* is predicated on the distinction between contractual claims and treaty claims. At some level this is obvious, but nonetheless there is disagreement as to the corollaries of this distinction. In the time remaining I will take three fields in which there is arbitral and academic disagreement. These are, first, contractual claims and counterclaims; secondly, umbrella clauses; and thirdly, the role of legitimate expectations (as contrasted to contractual rights) in the application of the fair and equitable treatment standard.

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<sup>27</sup> *Ibid.* 366, para. 98.

<sup>28</sup> *Ibid.* 367, para. 101.

<sup>29</sup> *Ibid.* 368, para. 105.

<sup>30</sup> *Ibid.* 369, para. 110.

<sup>31</sup> *Ibid.* 370, para. 111.

<sup>32</sup> *Ibid.* 370, para. 113.

<sup>33</sup> *Ibid.* 371, para. 115.

<sup>34</sup> *Compañía de Aguas del Aconquija SA and Compagnie Générale des Eaux/Vivendi Universal v. Argentine Republic*, ICSID Case no. ARB/97/3, Award, 15 August 2007, para. 11.1, available at <http://ita.law.uvic.ca/>

### III. CONTRACTUAL CLAIMS AND COUNTERCLAIMS UNDER BITS

If treaties and contracts were ‘clean different things’, one would expect them to inhabit different worlds. As between sovereigns there could be promises to submit investment disputes to arbitration but those promises would be interstate ones only: they would not sound in contract as against their intended beneficiaries – or at least they would not do so without domestic implementation. It should be noted that BITS are virtually never relied on as part of the internal law of the host state, and they will almost by definition not be part of the law of the seat of the arbitration. Lacking status (or having only doubtful and contingent effect) as internal law, they are relied on exclusively as treaties.

But even in legal systems which give no legal effect to treaties as such, a dualistic construction does not prevail. The established understanding is that an offer to arbitrate is contained in the BIT and is accepted by the investor’s notice of arbitration or by such other consent as the treaty may require. At that point, and not before, there is a perfected agreement to arbitrate between a qualified investor and the host state. As the English Court of Appeal said in *Republic of Ecuador v. Occidental Exploration and Production Co.*:

The treaty involves ... a deliberate attempt to ensure for private investors the benefits and protection of consensual arbitration; and this is an aim to which national courts should, in an internationalist spirit and because it has been agreed between states at an international level, aspire to give effect ... The present treaty at article VI(3)(a) holds out to investors on a standing basis the right to ‘choose to consent in writing to the submission of the dispute for settlement by binding arbitration’ ... and, at article VI(3)(b), once such consent is given, ‘either party to the dispute may initiate arbitration in accordance with the choice so specified in the consent’. The treaty expressly goes on to provide that the consent of the relevant state ‘hereby’ to the submission of any investment dispute for settlement by binding arbitration ... together with the investor’s written consent when choosing such arbitration, shall satisfy the requirement for written consent under the ICSID Convention and at article VI(4)(b) for ‘an “agreement in writing” for purposes of article II of the [New York] Convention’; and that any arbitration shall be held in a state party to that convention. This purpose can only be fulfilled, in a legal system with a dualist approach to international law like the English, if the operation of the mechanism for consensual arbitration in the treaty does in fact generate an ‘agreement in writing’. The application of the New York Convention depends on such an agreement, and the provisions of the Arbitration Act 1996 (sections 100–104) relating to the enforcement of foreign arbitral awards give effect to this requirement in English law. We would not in the circumstances accept ... that the consensual aspect of the arbitration contemplated in article VI of the treaty is a matter of mere form. It must, as it seems to us, have been intended to give rise to a real consensual agreement to arbitrate, even though by a route prescribed in the treaty.

Further ... the agreement to arbitrate which results by following the treaty route is not itself a treaty. It is an agreement between a private investor on the one side and the relevant state on the other.<sup>35</sup>

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<sup>35</sup> *Republic of Ecuador v. Occidental Exploration and Production Co.* [2005] EWCA Civ 1116, paras. 32–33 (Lord Phillips of Worth Matravers MR, Clarke, Mance LJ).

Thus, the separate agreement to arbitrate an investment claim under a BIT is a contract and not a treaty. If the agreement to arbitrate in *Occidental* had been a treaty, it would have been unenforceable and issues arising under it would have been non-justiciable before an English court, which the Court of Appeal expressly denied. The investor has neither international legal personality nor treaty-making capacity, and it does not acquire either merely by accepting an offer to arbitrate made in a treaty. If the agreement to arbitrate was a treaty, the resulting award would not be enforceable under the New York Convention of 1958, which has no application to international law arbitrations, *e.g.* between states or other international legal persons.<sup>36</sup>

But there is a distinction between a treaty the parties to which are international legal persons and a contract the proper law of which is international law. In the *Occidental* case, the Court of Appeal held that the proper law of the agreement to arbitrate is international law.<sup>37</sup> It could not be the law of the seat of the arbitration since the seat will often not be identified at the time the agreement to arbitrate was concluded, and English law cannot abide a floating proper law any more than nature a vacuum. Nor is it likely that the parties could have agreed on the law of the host state as the proper law of the arbitration agreement. That left international law as the only option. It was a credible option since the content of the agreement to arbitrate is determined largely by reference to the BIT, itself undoubtedly governed by international law. Thus, the BIT brings forth a binding commitment to arbitrate enforceable through national courts under national law, specifically under the Arbitration Act 1996. In short, a treaty breeds a contract.

That raises in turn the question whether a BIT can provide a basis for straightforward contractual jurisdiction, independently of any umbrella clause. If a treaty can provide a basis for consent to arbitrate treaty claims with the host state, why can it not provide a basis of consent to arbitrate contractual claims? Indeed it has done so: under the Claims Settlement Declaration which is part of the Algiers Accords of 1980, individual claimants brought thousands of contractual claims against Iran,<sup>38</sup> and it has been held that the resulting awards of the Iran-United States Claims Tribunal are enforceable under the New York Convention.<sup>39</sup>

Of course, contractual jurisdiction can only be asserted if the terms of the BIT were wide enough to encompass claims under investment contracts. Some BITS are quite clear in excluding that possibility. For example, under Articles 1116 and 1117 of the NAFTA, the only claims which may be submitted to arbitration are claims that another NAFTA Party has breached an obligation under specified

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<sup>36</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958, 330 UNTS 38, Arts. 1, 7.

<sup>37</sup> [2005] EWCA Civ. 1116, para. 33.

<sup>38</sup> D. Caron and J. Crook (eds.), *The Iran-United States Claims Tribunal and the Process of International Claims Resolution: a Study by the Panel on State Responsibility of the American Society of International Law* (Transnational Publishers Inc., New York, 2000), pp. 11–12.

<sup>39</sup> *Ministry of Defense of Iran v. Gould, Inc.*, 887 F.2d 1357 (9th Cir. 1989).

articles of Chapter 11 itself. Indeed, in some cases it has been clear that there were breaches of the investment contract by state organs: that might conceivably be taken into account in applying the minimum standard of treatment in Article 1105(1) on the NAFTA but it would only be relevant incidentally.

By contrast, the standard arbitration clauses in BITs make a clear distinction between investment disputes arising between investors and host states, and disputes concerning the interpretation and application of the BIT arising between the states parties to the BIT. The point was made by the *Vivendi Annulment* panel by reference to the France-Argentina BIT, which was in a fairly standard form. Article 8(1) provided that '[a]ny dispute relating to investments made under this Agreement between one Contracting Party and an investor of the other Contracting Party', if not settled by negotiation, could be referred either to the domestic courts or to international arbitration, the choice between them being final. There was no restrictive definition of 'dispute relating to investments'. As the Committee noted:

Article 8 does not use a narrower formulation, requiring that the investor's claim allege a breach of the BIT itself. Read literally, the requirements for arbitral jurisdiction in Article 8 do not necessitate that the Claimant allege a breach of the BIT itself: it is sufficient that the dispute relate to an investment made under the BIT. This may be contrasted, for example, with Article 11 of the BIT, which refers to disputes 'concerning the interpretation or application of this Agreement'.<sup>40</sup>

The issue arose in that case not because the claimants called on the tribunal to award damages under the concession contract – they expressly did not – but because the phrase '[a]ny dispute relating to investments' was capable of covering the same dispute, whether it was presented in the form of a claim under the substantive provisions of the BIT or a claim under the investment contract. Factually there was one dispute not two, whatever causes of action might be invoked. For that reason the Committee was of the view that the claimants, by invoking the jurisdiction of an international tribunal under Article 8, had taken the fork in the road and elected their remedy. In declining to decide the claim under the BIT, the first *Vivendi* tribunal had deprived the claimants of a right which the treaty expressly conferred.<sup>41</sup>

The implication of all this is that contractual jurisdiction can be invoked under any sufficiently clear generic dispute settlement clause in a BIT, such as Article 8 of the Argentina-France BIT which was applied in the *Vivendi* case. But this conclusion is subject to a number of qualifications which significantly limit its scope.

The first qualification is that the contractual claim must be characterised at the same time as a claim 'relating to investments'. Not every contract entered into by an investor is an investment contract: the classic example is an ordinary contract for the supply of goods and services.

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<sup>40</sup> (2002) 6 ICSID Rep. 340 at 356, para. 55.

<sup>41</sup> *Ibid.* 367–371, paras. 102–115.

The second qualification is that there can only be contractual jurisdiction under a BIT in respect of an investment contract with the state itself, not with a separate state entity having its own legal personality, and *a fortiori* not with a third party. It is sometimes argued that the question is one of attribution under Chapter 2 of Part I of the ILC's Articles on State Responsibility, but attribution has nothing to do with it. The issue of attribution arises when it is sought to hold the state responsible for some breach of an international obligation, including one arising under a substantive provision of a BIT. The problem here concerns jurisdiction, not merits; the formation of a secondary agreement to arbitrate, not the breach of a primary obligation concerning the protection of investments. In short, the question is one of interpretation of the jurisdictional offer, not attribution of conduct to the state.

The third qualification concerns the common case where the investment contract with the state contains its own exclusive dispute settlement clause. An investor invoking contractual jurisdiction pursuant to an offer made by the state must itself comply with its contractual arrangements for dispute settlement with that state. The principle *pacta sunt servanda* is not a one-way street. This was the basis for the majority holding in *SGS v. Philippines* that a *contractual* claim under a BIT cannot be pursued in breach of an applicable exclusive jurisdiction clause.<sup>42</sup> In *SGS v. Philippines* that issue arose under an umbrella clause, a matter to which I will return. But it would arise equally under a generic dispute settlement clause such as Article 8 of the France-Argentina BIT.<sup>43</sup> Indeed, it is arguable that under a generic dispute settlement clause this should be classified as an issue of jurisdiction properly so-called, and not one of admissibility. Whatever answer may be given to the question whether an investor can by contract in advance renounce the right to arbitrate treaty claims, there cannot be any doubt that it can renounce the right to arbitrate contract claims in a treaty forum. An exclusive jurisdiction clause in a contract is surely intended to do just that.

It is worth noting that the drafters of the 2004 US Model BIT sought to achieve essentially this result, though – in the tradition of that instrument – they did so by rather complex drafting. Article 24 of the Model BIT provides, in relevant part:

1. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation:
  - (a) the claimant, on its own behalf, may submit to arbitration under this Section a claim
    - (i) that the respondent has breached ...
      - (C) an investment agreement; and
    - (ii) that the claimant has incurred loss or damage by reason of, or arising out of, that breach ...

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<sup>42</sup> (2003) 8 ICSID Rep. 406 at 557–559, paras. 139–148.

<sup>43</sup> Agreement between the Argentine Republic and the Republic of France for the Promotion and Reciprocal Protection of Investments, 3 July 199, 1728 UNTS 298.

provided that a claimant may submit ... a claim for breach of an investment agreement only if the subject matter of the claim and the claimed damages directly relate to the covered investment that was established or acquired, or sought to be established or acquired, in reliance on the relevant investment agreement.<sup>44</sup>

Article 24 does not deal with the contingency of an exclusive jurisdiction clause in an investment agreement.

There is a second implication of all this, which concerns counterclaims. The core problem with counterclaims in BIT arbitration is that the treaty commitments of the host state towards the investor are unilateral, and anyway the investor is not a party to the BIT. Moreover the agreement to arbitrate, though it incorporates by reference the jurisdictional requirements of the BIT, does not incorporate its substantive provisions nor does it make them applicable bilaterally. In the case of a narrowly drawn counterclaim provision in the applicable arbitration rules, such as article 19(3) of the UNCITRAL Rules (article 19(3) of the PCA Rules), it will be argued that no counterclaim is possible because the host state's counterclaim would not 'arise out of the same contract' within the meaning of article 19(3).

In fact, two tribunals applying the terms of article 19(3) have held that counterclaims are in principle permissible.

*Reineccius and others v. Bank for International Settlements*<sup>45</sup> was not a BIT claim: it arose under the 1930 Convention respecting the Bank for International Settlements and concerned the amount of compensation payable for the recall of the 13.73 per cent of privately held shares in the Bank. The tribunal held that the claimants were entitled to compensation for their recalled shares corresponding to a proportionate share of the net asset value of the Bank, discounted by 30 per cent.<sup>46</sup> It also upheld the counterclaim of the Bank against one of the claimants, awarding the Bank's costs of defending proceedings brought by it in the United States in breach of the agreement to arbitrate.<sup>47</sup> Insofar as the breach concerned the agreement to arbitrate, a similar result could be achieved under a BIT, although presumably a claimant who has actually commenced a BIT arbitration will be careful not to pursue competing proceedings before national courts.<sup>48</sup>

More directly relevant is the second case, *Saluka BV v. Czech Republic*,<sup>49</sup> a decision of a tribunal presided over by Sir Arthur Watts. In a partial privatisation,

<sup>44</sup> 2004 US Model Bilateral Investment Treaty, Office of the US Trade Representative, available at [www.ustr.gov/index.html](http://www.ustr.gov/index.html)

<sup>45</sup> *Dr Horst Reineccius, First Eagle SoGen Funds, Inc., Pierre Mathieu and la Société de Concours Hippique de la Châatre v. Bank for International Settlements*, Partial Award on the Lawfulness of the Recall of the Privately Held Shares on 8 January 2001 and the Applicable Standards for Valuation of those Shares, 22 November 2002; Final Award on the Claims for Compensation for the Shares formerly Held by the Claimants, Interest Due Thereon and Costs of the Arbitration and on the Counterclaim of the Bank against First Eagle Sogen Funds, Inc, 19 September 2003, Permanent Court of Arbitration, available at [www.pca-cpa.org](http://www.pca-cpa.org) (hereafter *Bank for International Settlements*).

<sup>46</sup> *Ibid.* Partial Award, para. 202.

<sup>47</sup> *Ibid.* Final Award, paras. 103, 138(1) and (4).

<sup>48</sup> Cf. ICSID Convention, Art. 26.

<sup>49</sup> *Saluka Investments BV v. Czech Republic*, Decision on Jurisdiction over the Czech Republic's Counterclaim, Permanent Court of Arbitration, 7 May 2004, para. 81, available at [www.pca-cpa.org](http://www.pca-cpa.org)

Saluka had acquired a substantial minority shareholding in IPB, a Czech state-owned bank: in controversial circumstances IPB became insolvent, was put into administration and sold for a pittance to another bank. Saluka claimed violations of the deprivation of investment (Article 5) and fair and equitable treatment (Article 3) of the Netherlands-Czech Republic BIT. The Czech Republic brought a counterclaim which, *inter alia*, alleged breaches of the original share purchase agreement with the privatisation agency, a state organ. The arbitration was conducted under the UNCITRAL Rules.

In its interlocutory decision on the counterclaim, the tribunal said:

Both parties have ... accepted that counterclaims might fall within the scope of the Tribunal's jurisdiction under Article 8: the Respondent has done so by virtue of having presented such a counterclaim, and the Claimant has done so by acknowledging that circumstances could be envisaged in which a counterclaim could properly be made, as where a primary claim was presented on the basis of an investment contract and a counterclaim was presented on the basis of that same contract.<sup>50</sup>

The tribunal held that:

the jurisdiction conferred upon it by Article 8, particularly when read with Article 19.3, 19.4 and 21.3 of the UNCITRAL Rules, is in principle wide enough to encompass counterclaims. The language of Article 8, in referring to 'All disputes', is wide enough to include disputes giving rise to counterclaims, so long, of course, as other relevant requirements are also met. The need for a dispute, if it is to fall within the Tribunal's jurisdiction, to be 'between one Contracting Party and an investor of the other Contracting Party' carries with it no implication that Article 8 applies only to disputes in which it is an investor which initiates claims.<sup>51</sup>

However, jurisdiction in respect of the counterclaim, as for the primary claims, was circumscribed by Article 8 of the Treaty which refers to disputes 'concerning an investment'. The counterclaim had to satisfy that requirement to fall within the tribunal's jurisdiction.<sup>52</sup> In addition, 'a legitimate counterclaim must have a close connexion with the primary claim to which it is a response'.<sup>53</sup> The tribunal cited the ICSID arbitral decision in *Klöckner v. Cameroon*, which emphasised the need for the subject matter of the counterclaim to be intimately connected with the subject matter of the primary claim.<sup>54</sup> It also cited a number of Iran-United States Claims Tribunal decisions to similar effect.<sup>55</sup>

The tribunal stated that:

<sup>50</sup> *Ibid.* para. 38.

<sup>51</sup> *Ibid.* para. 39.

<sup>52</sup> *Ibid.* para. 60.

<sup>53</sup> *Ibid.* para. 61.

<sup>54</sup> *Klöckner v. Cameroon*, ICSID Case no. ARB/81/2, Decision on Annulment, 3 May 1985, 2 ICSID Rep. 162 at 165.

<sup>55</sup> See e.g., *American Bell International, Inc. v. Government of the Islamic Republic of Iran*, 19 September 1986, 12 Iran-US CTR 170; *Westinghouse Electric Corp. v. Islamic Republic of Iran*, 20 March 1997, 33 Iran-US CTR 60; *Owens-Corning Fiberglass Corp. v. Government of Iran*, 13 May 1983, 2 Iran-US CTR 322; *Morrison-Knudsen Pacific Ltd v. Ministry of Roads and Transportation*, 13 July 1984, 7 Iran-US CTR 54; *Harris International Telecommunications, Inc. v. Iran*, 2 November 1987, 17 Iran-US CTR 31.

Article 19.3 of the UNCITRAL Rules, Articles 25(1) and 46 of the ICSID Convention and Article II(1) of the Iran-US Claims Settlement Declaration, all reflect essentially the same requirement: the counterclaim must arise out of the ‘same contract’ (UNCITRAL Rules, Article 19.3), or must arise ‘directly out of an investment’ and ‘directly out of the subject-matter of the dispute’ (ICSID, Articles 25(1) and 46), or must arise ‘out of the same contract, transaction or occurrence that constitutes the subject matter of [the primary] claims’ (Article II(1) of the Claims Settlement Declaration). The Tribunal is satisfied that those provisions, as interpreted and applied by the decisions which have been referred to, reflect a general legal principle as to the nature of the close connexion which a counterclaim must have with the primary claim if a tribunal with jurisdiction over the primary claim is to have jurisdiction also over the counterclaim.<sup>56</sup>

The tribunal concluded it was without jurisdiction in respect of the respondent’s counterclaim on the basis that the disputes:

which have given rise to the Respondent’s counterclaim are not sufficiently closely connected with the subject-matter of the original claim put forward by Saluka to fall within the Tribunal’s jurisdiction under Article 8 of the Treaty.<sup>57</sup>

To summarise, where the host state has a counterclaim arising from the investment contract which falls within the description of a dispute concerning an investment within the terms of the relevant BIT, such a counterclaim may be admissible depending on the actual connection with the primary claim. The term ‘contract’ in article 19.3 of the UNCITRAL Rules should be interpreted to include the BIT on which the investor’s claim is based, and where there is a generic dispute settlement clause in the BIT claims by the host state under an investment contract to which it is a party, counterclaims under the investment contract may be admissible. *A fortiori* this should be true when the ICSID Arbitration Rules apply: article 40 refers to ‘a counter-claim arising directly out of the subject-matter of the dispute’, and as in *Vivendi* a treaty claim and a contract claim, while remaining legally distinct causes of action, may have the same subject matter. To conclude, contractual claims and counterclaims may be brought under appropriately worded BITs.

This conclusion seems desirable as a matter of policy as well as law. Despite the inherently asymmetrical character of a BIT, BIT tribunals should be able to hear closely connected investment counterclaims arising under the investment contract. Otherwise the maxim *pacta sunt servanda* operates in only one direction.

#### IV. CONTRACTUAL CLAIMS AND THE UMBRELLA CLAUSE

I turn to my second major theme, the so-called ‘umbrella clause’. Anthony Sinclair has usefully traced the origins of the umbrella clause back to their origins

<sup>56</sup> *Saluka Investments BV v. Czech Republic*, Decision on Jurisdiction over the Czech Republic’s Counterclaim, 7 May 2004, para. 76.

<sup>57</sup> *Ibid.* para. 81.



in the aftermath of the *Anglo Iranian Oil Company* case in 1952.<sup>58</sup> It is not the least of the criticisms to be levelled at the narrow interpretations of the umbrella clause that they disregard this history.

I should start with the standard proviso, deriving from my first general principle. Some umbrella clauses are more equal than others to the interpretative weight put upon them – or to put it in less Orwellian terms, everything depends on their actual language. For example, the clause at issue in *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan*<sup>59</sup> provided that:

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.

This was rightly held not to involve any guarantee by the host state with regard to specific transactions.<sup>60</sup> It was not an umbrella clause at all. Likewise, the clause in *SGS v. Pakistan* was curiously worded and might have given grounds for a narrower construction.<sup>61</sup> In what follows I will limit myself to umbrella clauses by which the host state commits itself to comply with obligations it has entered into with regard to investments. For example, the 1984 and the 1987 US Model BITs provided that: ‘Each Party shall observe any obligation it may have entered into with regard to investments’. The 2004 US Model BIT abandoned this formulation, adopting instead the jurisdictional provision with regard to investment agreements to which I have already referred. But similar provisions subsist in the UK, Swiss and German Model BITs. No doubt in consequence, around 40 per cent of BITs contain some version of an umbrella clause.

There is neither the time nor would it be productive to go into the details of the 20 or so cases in which umbrella clauses have been discussed. It is sufficient to identify four schools of thought, if you like, four camps – though some of the dwellers in particular camps may be thought to have a nomadic attitude and to move from camp to camp as the feeling takes them.

The first camp adopts an extremely narrow interpretation of umbrella clauses, holding that they are operative only where it is possible to discern a shared intent of the parties that any breach of contract is a breach of the BIT.<sup>62</sup> The second camp seeks to limit umbrella clauses to breaches of contract committed by the

<sup>58</sup> *Anglo-Iranian Oil Co. Case (Jurisdiction)* [1952] ICJ Rep. 93. See A.C. Sinclair, ‘The Origins of the Umbrella Clause in the International Law of Investment Protection’ in (2004) 20 *Arb. Int'l* 411.

<sup>59</sup> *Salini Costruttori SpA and Italstrade SpA v. Hashemite Kingdom of Jordan*, Decision on Jurisdiction, ICSID Case no. ARB/02/13, 29 November 2004, (2005) 44 ILM 569.

<sup>60</sup> *Ibid.* paras. 126–127.

<sup>61</sup> *SGS v. Pakistan*, *supra* n. 8, Decision on Jurisdiction, 6 August 2003. Pakistan-Switzerland BIT, Art. 11, provides that ‘Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the other Contracting Party’.

<sup>62</sup> See e.g., *SGS v. Pakistan*, *supra* n. 8 at paras. 163–174; *Joy Mining Machinery Ltd v. Arab Republic of Egypt*, ICSID Case no. ARB/03/11, Award on Jurisdiction, 6 August 2004, paras. 80–81, available at <http://icsid.worldbank.org/ICSID/>

host state in the exercise of sovereign authority.<sup>63</sup> A third view goes to the other extreme: the effect of umbrella clauses is to internationalise investment contracts, thereby transforming contractual claims into treaty claims directly subject to treaty rules.<sup>64</sup>

Finally there is the view that that an umbrella clause is operative and may form the basis for a substantive treaty claim, but that it does not convert a contractual claim into a treaty claim. On the one hand it provides, or at least may provide, a basis for a treaty claim even if the BIT in question contains no generic claims clause;<sup>65</sup> on the other hand, the umbrella clause does not change the proper law of the contract or its legal incidents, including its provisions for dispute settlement.

In accordance with the general principles articulated above, there are major difficulties with the first three positions. The first effectively deprives the umbrella clause of any content, contrary to the principle of *effet utile* and to the apparent intent of the drafters. The second imposes a characterisation test at the level of breach for which there is no textual warrant and which is capable of producing arbitrary results. One may, for example, take the formulation of the tribunal in the *CMS* case:

Purely commercial aspects of a contract might not be protected by the [umbrella clause] 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.<sup>66</sup>

There are two obvious responses to this. The first is that it does not provide a reliable or even a determinate test for determining whether a tribunal has jurisdiction. Instead it calls for an appreciation of the character of or motive for the breach, which in most cases would require a hearing on the merits. The second response is that it would be very odd indeed if a state could defend itself against a claim for repudiation of an investment agreement by arguing that it was acting for commercial reasons!

No doubt there are genuine concerns driving the restrictive view, which is to a significant extent a reaction against the equal and opposite defects of the third view. These need to be addressed.

<sup>63</sup> *Pan American Energy LLC and BP Argentina Exploration Co. v. Argentina*, ICSID Case no. ARB/03/13, Decision on Preliminary Objections, 27 July 2006, paras. 96–113; *El Paso Energy International Co. v. Argentina*, ICSID Case no. ARB/03/15, Decision on Jurisdiction, 27 April 2006, paras. 66–88, available at <http://icsid.worldbank.org/ICSID/>.

<sup>64</sup> *Fedax v. Venezuela*, ICSID Case no. ARB/96/3, Decision on Jurisdiction, 11 June 1997, 5 ICSID Rep. 186; Award, 9 March 1998, 5 ICSID Rep. 200, para. 29; *Eureko BV v. Republic of Poland*, ad hoc Arbitration, Partial Award, 19 August 2005, 12 ICSID Rep. 331, paras. 244–260, *cf.* dissenting opinion of Rajska, para. 11; *Noble Ventures Inc. v. Romania*, Award, ICSID Case no. ARB/01/11, 12 October 2005, paras. 46–62, available at <http://icsid.worldbank.org/ICSID/>.

<sup>65</sup> *SGS v. Philippines*, *supra* n. 8; *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case no. ARB/01/8, Decision of the ad hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007.

<sup>66</sup> *CMS v. Argentina*, Award, 12 May 2005, para. 299, available from: <http://icsid.worldbank.org/ICSID/FrontServlet> (emphasis added).

First there is the problem of scope:

the ‘commitments’ subject matter of Article 11 may, without imposing excessive violence on the text itself, 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, under the law on state responsibility, attributable to the State itself.<sup>67</sup>

But as we have seen, the question of the scope of a commitment to arbitrate made by the State is a matter of interpretation and has nothing to do with attribution. International law does not treat separate entities with their own legal personality as part of the State for all purposes.

Then there is the possibility that an umbrella clause might enable an investor to evade agreed-upon exclusive jurisdiction arrangements in the investment contract, whether these provide for domestic courts or local or international arbitration. Thus, the *SGS v. Pakistan* tribunal was not convinced:

that Article 11 of the BIT has had the effect of entitling a Contracting Party’s investor, like SGS, in the face of a valid forum selection contract clause, to ‘elevate’ its claims grounded solely in a contract with another Contracting Party ... to claims grounded on the BIT, and accordingly to bring such contract claims to this tribunal for resolution and decision.<sup>68</sup>

I agree entirely with this concern. But it implies that the obligations of a host State under a general BIT are to be applied without regard to the conduct, including the contractual obligations, of the investor. That is not, and ought not to be, the case, as *SGS v. Philippines* showed.

Then there is a concern about flooding ICSID with minor contractual claims, a classic floodgates argument to which standard floodgates responses may be made. BIT arbitration is expensive and even to a successful claimant costs are usually not awarded. The characterisation of a claim as contractual or otherwise is essentially a matter of technique and bears no relation to the frequency or otherwise with which investment disputes arise and are submitted to arbitration.

Fourth and most significant, there is the concern that the umbrella clause leads to a freezing of host State sovereignty, a sort of closet stabilisation. And there is reason for the concern. For example, the tribunal in *LG&E v. Argentina* felt able to say that:

[t]hese laws and regulations became obligations within the meaning of Article II(2)(c), by virtue of targeting foreign investors and applying specifically to their investments, that gave rise to liability under the umbrella clause.<sup>69</sup>

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<sup>67</sup> 8 ICSID Rep. 406 at 443, para. 166.

<sup>68</sup> *Ibid.* 442, para. 165.

<sup>69</sup> *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentina*, ICSID Case no. ARB/02/1, Decision on Liability, 3 October 2006, para. 175, available at <http://icsid.worldbank.org/ICSID/>

But it is a confusion to equate a state law or regulation with an obligation entered into by the state, or to regard an umbrella clause as implicitly freezing the laws of the state as at the date of admission of an investment. The enactment of a law by a state, whether it is specific or general, is not the entry by the state into an obligation distinct from the law itself. No doubt a state is obliged by its own laws, but only for so long as they are in force. In the absence of express stabilisation, investors take the risk that the obligations of the host state under its own law may change, and the umbrella clause makes no difference to this basic proposition.

In short, under the integrationist view as applied to standard umbrella clauses the claims are still contractual and they are still governed by their own applicable law. The distinction between treaty and contract is maintained. The purpose of the umbrella clause is to allow enforcement without internationalisation and without transforming the character and content of the underlying obligation.

This can be seen from the decision of the ad hoc Committee in *CMS v. Argentina (Annulment)*, where the tribunal's conclusion on the umbrella clause was annulled. The relevant paragraph of the decision reads as follows:

95. Moreover there are major difficulties with this broad interpretation of Article II(2)(c).

- (a) In speaking of 'any obligations it may have entered into with regard to investments', it seems clear that Article II(2)(c) is concerned with consensual obligations arising independently of the BIT itself (*i.e.* under the law of the host State or possibly under international law). Further they must be specific obligations concerning the investment. They do not cover general requirements imposed by the law of the host State.
- (b) Consensual obligations are not entered into *erga omnes* but with regard to particular persons. Similarly the performance of such obligations or requirements occurs with regard to, and as between, obligor and obligee.
- (c) The effect of the umbrella clause is not to transform the obligation which is relied on into something else; the content of the obligation is unaffected, as is its proper law. If this is so, it would appear that the *parties* to the obligation (*i.e.*, the persons bound by it and entitled to rely on it) are likewise not changed by reason of the umbrella clause.
- (d) The obligation of the State covered by Article II(2)(c) will often be a bilateral obligation, or will be intrinsically linked to obligations of the investment company. Yet a shareholder, though apparently entitled to enforce the company's rights in its own interest, will not be bound by the company's obligations, *e.g.* as to dispute settlement.
- (e) If the Tribunal's implicit interpretation is right, then the mechanism in Article 25(2)(b) of the ICSID Convention is unnecessary wherever there is an umbrella clause.
- (f) There is no discussion in the award of the *travaux* of the BIT on this point, or of the prior understandings of the proponents of the umbrella clause as to its function.

The tribunal's decision on this point was annulled for failure to state reasons, leaving open the question whether a broad interpretation of the umbrella clause would have involved a manifest excess of power even if it had been properly motivated.

For these reasons, the better view is the integrationist one: the umbrella clause is an extra mechanism for the enforcement of claims, but the basis of the transaction remains the same.

## V. LEGITIMATE EXPECTATIONS

I turn to the third and final theme in this article: the doctrine of ‘legitimate expectations’ and its relationship to contract in the investment treaty context. The public law principle of ‘legitimate expectations’ is present in many domestic legal systems. It requires that state authorities respect the ‘legitimate expectations’ of individuals created through statements of policy or intention as part of their general duty of fairness, particularly when directed at a particular individual or entity.<sup>70</sup> It is now well established that disappointed expectations can, in some circumstances, be relevant to a claim under international investment treaties.

However, there are conflicting views as to the application of the legitimate expectations principle in the investment treaty context. One frequently cited statement comes from the arbitral tribunal’s award in *TECMED v. Mexico*.<sup>71</sup> *TECMED*, a company incorporated in Spain, successfully claimed for damages arising out of Mexico’s treatment of its investment in a hazardous waste facility located in Hermosillo, Sonora, Mexico, in particular the failure of the Mexican environmental authorities to renew a licence for the facility.

The tribunal held that Mexico had breached the obligations owed to the Spanish investor under Articles 4(1) (fair and equitable treatment) and 5(1) (nationalisation and expropriation) of the Mexico-Spain BIT.

In terms of the Article 4(1) obligation of fair and equitable treatment, the tribunal observed that this obligation required the Contracting Parties to afford treatment that did not undermine the reasonable expectations forming the basis of the investor’s decision to invest in the country. Part of those expectations, according to the tribunal, is that the host state will act in a non-arbitrary, transparent manner so that the investor can plan and adjust its conduct according to clear rules. The tribunal considered:

that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to 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. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the

<sup>70</sup> See e.g., S. Schönberg, *Legitimate Expectations in Administrative Law* (OUP, Oxford, 2000).

<sup>71</sup> *Técnicas Medioambientales TECMED SA v. United Mexican States*, ICSID Case no. ARB (AF)/00/2, Award, 29 May 2003, 10 ICSID Rep. 130.

required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle.<sup>72</sup>

Other recent awards have endorsed similar standards of conduct. In *Occidental v. Ecuador*, the tribunal held that '[t]he stability of the legal and business framework is thus an essential element of fair and equitable treatment'.<sup>73</sup> In *CMS Gas Transmission Co. v. Argentine Republic*, the tribunal referred to the Preamble to the relevant BIT which recited that it is desirable 'to maintain a stable framework for investments and maximum effective use of economic resources'. The tribunal held that 'fair and equitable treatment is inseparable from stability and predictability'.<sup>74</sup>

In his lengthy separate opinion in *Thunderbird Gaming v. Mexico*, Prof. Wälde engaged in a detailed comparative analysis of the principle of legitimate expectations.<sup>75</sup> He noted that although his survey:

does not specify exactly the contours of this principle, it suggests that under developed systems of administrative law, a citizen – even more so an investor – should be protected against unexpected and detrimental changes of policy if the investor has carried out significant investment with a reasonable, public-authority initiated assurance in the stability of such policy ... The wide acceptance of the 'legitimate expectations' principle therefore supports the concept that it is indeed part of 'fair and equitable treatment' as owed by governments to foreign investors under modern investment treaties and under Art. 1105 of the NAFTA.<sup>76</sup>

And he concluded that:

One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the 'fair and equitable standard' as under Art. 1105 of the NAFTA.<sup>77</sup>

Also of relevance in this context is the award and subsequent decision of the ad hoc annulment committee in *MTD v. Chile*.<sup>78</sup> The tribunal applied the *TECMED* standard quoted above, and held that Chile had breached its obligation of fair and equitable treatment under Article 3(1).<sup>79</sup>

<sup>72</sup> *Ibid.* 192–193, para. 154.

<sup>73</sup> *Occidental Exploration and Production Co. v. Republic of Ecuador*, LCIA Case no. UN 3467, Final Award, 1 July 2004, 14 ICSID Rep. 54, para. 183.

<sup>74</sup> *CMS v. Argentina*, *supra* n. 66, Award, para. 276.

<sup>75</sup> *International Thunderbird Gaming Corp. v. United Mexican States*, Arbitral Award, 26 January 2006.

<sup>76</sup> *Ibid.* Sep. Op., para. 30.

<sup>77</sup> *Ibid.* Sep. Op., paras. 30–37.

<sup>78</sup> *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile*, ICSID Case no. ARB/01/7, Award, 25 May 2004, 12 ICSID Rep. 3; Decision on the Application for Annulment, 21 March 2007.

<sup>79</sup> *Ibid.* Annulment, para. 22.

In the annulment proceedings, the claimant argued, *inter alia*, that the tribunal misapprehended the standard of fair and equitable treatment under the BIT, applying the standard expressed in a dictum of the *TECMED* tribunal quoted above, which was in no way representative of international law. According to the respondent, ‘the *TecMed* programme for good governance’ is extreme and does not reflect international law.<sup>80</sup> The ad hoc Committee held that:

legitimate expectations generated as a result of the investor’s dealings with the competent authorities of the host State may be relevant to the application of the guarantees contained in an investment treaty.<sup>81</sup>

While the Committee ‘appreciate[d] some aspects of [the respondent’s] criticisms’, the tribunal did not manifestly exceed its powers in the account it gave of the fair and equitable treatment standard.<sup>82</sup>

In my view, the decision of the ad hoc Committee in *MTD v. Chile* takes the preferable approach regarding the application of the legitimate expectations principle in the investment treaty context. The investor’s expectations may be relevant to the application of the standards and obligations contained in the relevant investment treaty, in particular the fair and equitable treatment standard. However, the expectations of the investor cannot act as a substitute for the relevant contractual and treaty arrangements. In the words of the ad hoc Committee:

The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from such expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly.<sup>83</sup>

Reference to a general and vague standard of legitimate expectations is no substitute for contractual rights. The relevance of legitimate expectations is not a licence to arbitral tribunals to rewrite the freely negotiated terms of investment contracts.

## VI. CONCLUSIONS

To conclude, treaties and contracts are different things. But they are not clean different things, in the sense of inhabiting different worlds: between them there is no great gulf fixed. No doubt distinctions between legal systems should be observed, but not at the expense of appropriate connections between them. There is a distinction between treaty and contract, but they are part of the same

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<sup>80</sup> *Ibid.* Chile’s Annulment Reply, para. 57.

<sup>81</sup> *Ibid.* Annulment, para. 69.

<sup>82</sup> *See ibid.* Award, para. 113.

<sup>83</sup> *Ibid.* Annulment, para. 67.

one world with many legal systems that international arbitrators have long inhabited.

Applied to international arbitration this insight produces consequences both for jurisdiction and merits. The core point is that a covered investment is a transaction involving a qualified investor and the host state. Contractual or other commitments by each to the other go to define the investment: as *Mihaly v. Sri Lanka* held, if there is no intention to enter into legal relations then there is no investment.<sup>84</sup> What a BIT does is to provide an additional layer of protection for the one transaction: the investment is protected by the BIT, but the BIT should not be used as a vehicle to rewrite the investment arrangement. At the level of jurisdiction, and subject always to the caveat that what matters is the actual language of the BIT, there is no reason to interpret a BIT as not covering contractual claims or counterclaims concerning the investment. There may be, as with appropriately-worded umbrella clauses, an international obligation to observe the investment contract, though this does not convert the contract into a treaty or change its applicable law. At the level of the merits it must be borne in mind that the investment contract is itself an allocation of risks and opportunities, and that that allocation is relevant in determining, in particular, whether there has been fair and equitable treatment under the BIT. In particular, the doctrine of legitimate expectations should not be used as a substitute for the actual arrangements agreed between the parties, or as a supervening and overriding source of the applicable law.

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<sup>84</sup> *Mihaly International Corp. v. Democratic Socialist Republic of Sri Lanka*, ICSID Case no. ARB/00/2, Award, 15 March 2002, 6 ICSID Rep. 308 at 320, para. 51.