The "Umbrella" (or Sanctity of Contract/Pacta sunt Servanda) Clause in Investment Arbitration:

A Comment on Original Intentions and Recent[1]

Thomas W. Wälde
CEPMLP/Dundee

Introduction

The extent to which customary law (in the past) and modern investment treaties (bilateral/multilateral) at present protect contracts concluded with the state and its attributed entities has been controversial in the past and continues to be so. The issue has been emerging as one of the key challenges in modern direct investor-state investment arbitration ("arbitrage transnational") as over 2000 BITs have by now been concluded and several plurilateral or multilateral investment treaties amounting to the equivalent of more than another 2000 BITs[2]. Governments, tribunals and scholars have been divided on the scope of such protection to be offered[3]. As usually, there is an

---

[1] SGS v. Pakistan, Jurisdictional Decision, published in ILM, November 2003. SGS v. Philippines ICSID Case No. ARB/02/6 (January 29, 2004) published: 42 ILM 1285 (2003).

I gratefully acknowledge comments by Anthony Sinclair;Joern Griebel, Charles Leben and Walid Benhamida. *For a complete comment on the SGS v Pakistan case S. Alexandrov, Introductory note, 42 ILM 1285 (2003). Mr Alexandrov will also write a comment on both cases for the J of World Investment, 2004. Mr Sinclair has written, in dialogue with me, a comment on the history of the umbrella/sanctity clause.*

ICSID cases cited are available as a rule from www.worldbank.org/icsid; sometimes also published in the ICSID-Review, ICSID Reports and ILM. For a comprehensive table of cases, Benhamida, L'arbitrage transnational unilatéral. réfléxions sur une procédure résérvée à l'initiative d'une personne privée contre une personne publique, 2004 (forthcoming), based on his 2003 Paris II doctoral thesis. I understand Norbert Horn's forthcoming book on Investment Arbitration will also include a comprehensive table of cases. A number of the cases cited and case comments are also regularly published in OGEL – at www.gasandoil.com/ogel.

[2] Mainly the NAFTA (US, Canada, Mexico) and the Energy Charter Treaty (over 50 states plus the European Communities).

[3] See among many others the as usually incisive analysis by F. A. Mann State contracts and State responsibility, 54 AJIL 572 (1960); R. Jennings, State Contracts in International Law, 37 BYIL 156 (1961); Stephen Schwebel, "International Protection of Contractual Agreements" (1959) A.S.I.L. Proc. 273 and idem, The Breach by a State of a contract , in: Essays in Honour of Roberto Ago, Milano, Giuffre 1987, also: published as: On Whether the Breach by a state of a contracxt with an alien is a breach of international Law, in: Justice in INternatonal Law, Selected

approach highlighting state sovereignty which provides a large, unfettered leeway for abrogation of such contracts by governments relying on domestic law; this view is largely affiliated with the adherents of the 1970s concept of the "New International Economic Order" and the then in developing countries prevailing, subsequently waning and now possibly re-emerging Calvo doctrine[4]. The opposite view – associated at least since the 1920s (and probably much earlier)[5] – reflects the needs of international commerce, now under the concept of "good governance" for the "global economy" and emphasises that contracts freely entered into by governments can not be cancelled without full compensation. General views on the desirability of protecting aliens' contracts and other proprietary rights, the specific context of particular litigated disputes and sentiments about the proper balance between unrestricted national sovereignty on one hand and the controls imposed by international law on the exercise of governmental power all have been playing a role in determining attitudes and legal argument.

The Background: Liberal Good-Governance of Global Economy versus Nationalist and Statist Positions under the "Sovereignty" Label

Debate and jurisprudence have been pulled by conflicting forces: On one hand, it is recognised that a "culture of commitment" is part and parcel of effective good governance; no society where contracts are not honoured has ever been able to develop economically, achieve prosperity and qualify as a well-governed society[6]. From all indicators

---

Writings of Stephen Schwebel, Grotius, Cambridge 1994, 425; 401; most recently on coverage by BITs of contract claims: B. Cremades, Clarifying the Relationship Between Contract and Treaty Claims in Investor-State Arbitrations, in: N. Horn (Ed) Investment Arbitration, forthcoming 2004.

[4] *The most recent presentation: DM. Sornarajah, The International Law on Foreign Investment Cambridge 1994.; on the context: T. Wälde, A Requiem for the New International Economic Order, in: : Liber Amicorum Professor Ignaz Seidl-Hohenveldern, Ed.G. Hafner et.al. Kluwer 1998; Garcia-Amador, F., V., "Calvo Doctrine, Clavo Clause", in Bindshedler, R., L., (ed.), Encyclopaedia of Public International Law, Volume One (1992), pp. 521-523; Francisco Orrego Vicuna 11 N.Y.U. Envtl. L.J. 19 (2002), Regulatory Expropriations In International Law: Carlos Calvo, Honorary Nafta Citizen.*

[5] *It is likely that a more thorough historical analysis will find such emphasis on a culture and legal order protecting contractual commitments in all historical periods with a developed commercial intercourse among nations – and not least in Islamic Law where the principle of sanctity of contract is supported by the following verse from the Holy Quran. "Oh you who believe, observe covenants". (Almaeda Sura, Chapter 5, verse 1)*

[6] *Manfred Streit, Michael Wohlgemuth, The Market Economy and the State: Hayekian and ordoliberal conceptions, Max Planck Institute for Research into Economic*

it appears that underdevelopment and lack of an effective culture of contractual commitment are closely correlated. Countries that are underdeveloped and in difficulty when trying to transit to the status of developed market economies as a rule suffer from an absence of a "culture of commitment", anchored in live – i. e. not only formal – law, legal institutions and respect by government and the relevant actors in society for engagements undertaken. External disciplines – such as provided by international economic treaties(WTO, IT's) and by economic integration agreements (EU) – help to fasten such strategic elements of good-governance to enforceable legal systems not fully under the control of domestic forces[7]. If international economic treaties should help prosperity – in particular in the investment-receiving society, then they do have to anchor and reinforce a culture of contractual commitment against forces which tend to combine economic authoritarianism, legal anarchism, xenophobia and protectionism under the cloak of popular and legal sovereignty.

On the other hand, it is recognised that international law enforced by investment arbitration tribunals can not become a supranational legal system for the infinite number of government procurement and other contract disputes just because foreign operators are involved; nor should tribunals set up by investment treaties replace the task of domestic courts or assume, as is often said, a general supranational appeals authority[8]. One needs, though, to recognise that international law (through the WTO General Agreement on Procurement, EU procurement rules and the lending conditions of international financial institutions) has entered into government contracting much more than is realised by general public international or commercial arbitration lawyers[9]. Similarly, the often repeated rejection of the function of a

---

Systems, Jena, Discussion paper 06-97 with a summary of the concepts by Boehm, Eucken and Hayek; Deepak Lal and H. Myint, The Political Economy of Poverty, Equity and Growth, a comparative study, Clarendon Oxford 1996; Mancur Olson, Power and Prosperity, Basic Books, New York 2000

[7] *Developed by the chief GATT thinker Jan Tumlir and popularised by E.U. Petersmann, see, among many others: National constitutions and International Economic Law, (p. 1-52) in: Meinhard Hilf/Ernst-Ulrich Petersmann, National Constitutions and Int'l Economic Law, Kluwer Deventer 1993*

[8] *This theme is repeated in many recent arbitral awards – e.g. Azinian v. Mexico (NAFTA), but it is rarely thought through: Formally, investment arbitral tribunals are never supranational appeals body, but from a more material perspective, they provide – as appeals courts do – a recourse to judicial decision-making when the domestic option either appears non-appealing or in some cases when the domestic recourse has failed to satisfy the aggrieved investor.*

[9] *S. Arrowsmith , Transparency in government procurement: the objectives of regulation and the boundaries of the WTO, 37 J World Trade, 2003; Mary Footer, Remedies Under the New Gatt Agreement on Government Procurement,*

"supranational appeals" body is not well thought through: International economic law – in the quite distinct shape of jurisprudence by the European Court of Justice, The European (or Inter-American) Court of Human Rights or in the more universal form of WTO adjudication is exercising legal powers which can – and often do – overrule at least in effect, domestic courts[10]. In investment treaties, this function is even more present as – explicitly recognised or just for politeness reasons quietly assumed – courts of most developing countries are not seen to be as a rule independent from government or immune from political pressure and even corruption[11]. Arbitration tribunals will rarely if ever acknowledge this explicitly, but recourse to them by arbitration agreement or investment treaty is to a significant extent motivated by the lack of trust and international acceptability of domestic courts in emerging economies[12]. This lack of trust may not be justified in every single situation, but is based on a pervasive, and probably quite realistic perception that domestic courts in developing countries are – as most other organs of government – not properly resourced, professionally not very competent and, most of all, unable to live up to the standards of integrity generally expected from a proper judicial system[13]. This widely perceived weakness of many host states' judicial system naturally encourages the search for international controls – including those offered by investment-treaty based arbitral jurisdiction.

The position of customary international law with respect to contracts of foreigners with government moves between both poles. It is hard to summarise where sophisticated lawyers such as Francis Mann have ventured into complex, and in the end not clearly determined positions. Most of the traditional (i.e. 1950s and 1960s) discussion emphasises the "sanctity of contract" reinforced by an international

---

Sweet and Maxwell 80-93 (1995)

[10] *Ernst-Ulrich Petersmann, Proliferation And Fragmentation Of Dispute Settlement In International Trade: WTO Dispute Settlement Procedures And Alternative Dispute Resolution Mechanisms, 2004, manuscript.*

[11] *Richard Kreindler, Aspects of Illegality in the Formation and Performance of Contracts, OGEL archive at www.gasandoil.com/ogel; William Park, Determining arbitral jurisdiction: allocation of tasks between courts and arbitrators, 8 Am.Review of Intl arbitraiton 133 (1997);*

[12] *This assumption did play a role in the Hilmarton-Chromalloy cases, and also in the lack of external enforceability of most of the anti-arbitration injunctions issued by domestic courts in developing host states involved in investment disputes, CA Paris, Egypte v Chromalloy Rev Arb 395 (1997); XXIIYBCA 691 (1997).*

[13] *EBRD and the World Bank have been carrying out analysis of the effectiveness and perception of integrity of domestic courts – http://www1.worldbank.org/publicsector/anticorrupt/legal.htm*

law protection of foreign investor contracts with governments; but at the same time, most observers are aware of the difficulty of both protecting such contracts on the level of international law, while recognising the role of contract law, remedies and domestic jurisdiction in particular for breaches which are rather of a commercial, contractual nature and do not implicate an abuse of governmental power[14]. This classic discussion – which, 50 years later, requires our renewed attention – has its own, selective, filter: It focuses explicitly[15] or implicitly primarily on "concessions" or "concession contracts" which were then seen as a contract-like instrument subject primarily to administrative law and similar contractual documents relating to operations in the oil, energy and infrastructure sectors[16]. The cases cited in these early proposals out of which the "pacta sunt servanda" clause emerges tend to be mainly, apart from loans, from the area of mineral or public-infrastructure concession contracts[17]. It is also to a considerable extent based on the assumption that states – not individual investors – will enforce before proposed arbitral institutions (later to become the ICSID convention) expropriatory actions of governments with respect to contracts. This then prevailing perspective is significant and not as yet properly appreciated:

---

[14] F. A. Mann, op. cit. supra; Schwarzenberger, 1969, p. 117 in his commentary on Art. 2 – observance of undertakings – of the draft Abs-Shawcross Convention; Justus Alenfeld, Die Investitionsfoerderungsvertraege der Bundesrepublik Deutschland, p.96, 97 (suggesting the application of domestic law and international contract law principles such as rebus sic stantibus to the pacta sunt servanda clause, first introduced by the German BITs in 1959. Gesellschaft, Heft 3, infra, p. 101 where the point is made that a state that uses its sovereign power to frustrate the legitimate expectation that it will observe its contractual undertakings breaches international law (from reply by the US section of the international law association on the expropriation questionnaire of the ILA of 20 February 1958. The members included James Hyde, Kenneth Carlston, Martin Domke, Richard Gardner, Philip Jessup and Stephen Schwebel.

[15] Note most explicitly Art. III (e) of the "Abs-Doelle" convention draft (one of the two precursors to the subsequent Abs-Shawcross model convention), at p. 96/97 of: Gesellschaft zur Foerderung des Schutzes von Auslandsinvestitionen, Heft 2, Koeln 1958 (probably).

[16] Gesellschaft, op. cit. supra at p. 28-31 citing, inter alia, the 1936 Argentine electricity concessions, the Compagnie universelle du canal de Suez nationalisation and nationalisation, starting in Mexico in 1927, of petroleum concessions.; Gesellschaft, Heft 3, infra, p. 100 referring to the Serbian loans, the El-Triunfo, the Landreau and Shufeld claims, the Radio Corporation of America cases, N. American Dredging v Mexico and other cases of the inter-war period.

[17] Gesellschaft zur Foerderung des Schutzes von Auslandsinvestitionen, Heft 3, Koeln, 1960, p. 100/101 – translating reply of the US section of the International Law Association to a questionnaire of the international expropriation committee of 20 February 1958; the English version is published in S. Schwebel, 1994, op.cit, 385-400; on the significance of concession dispute arbitration in the inter-war period also Schwebel/Wetter, Some Little-Known Cases on Concessions, ibidem, 436-489.

Governments, as we know in the NAFTA context, notoriously unwilling to sponsor claims by their investors, can exercise an important "screening" function if there is only an intergovernmental arbitration recourse. With modern investment arbitration, this screening function no longer exists. All government conduct envisaged by this debate and search for international institutions (ultimately resulting in the ICSID Convention and the failed 1998 Multilateral Agreement on Investment) had an expropriatory nature, e.g. the discussion then envisaged not a commercial law breach, but rather governmental action abrogating a long-term – mostly concession-like – agreement. The contracts underlying this debate were not, for example, sales or services contracts, but rather "investment"-related – but not in the modern sense of the very wide notion of "investment" encompassing all assets, but rather in the sense of "foreign direct investment" with a long and substantial commitment of capital, ownership and control. Lastly, the proposed legal solutions were intended to provide and affirm a legal position that was the opposite of the nationalist and socialist positions then taken. These positions – reflected in the Iranian pleading in the Anglo-Iranian case[18] - suggested unconditional subjection of such contracts to domestic law. The 1950s discussion and their outcomes – the 1966 ICSID Convention, the 1963 and 1969 OECD Model Convention and ultimately the now 2000+ bilateral and multilateral investment treaties – were expressly meant to set up an internationalised counter-programme to the nationalist and socialist position of the time. This context and underlying assumptions need to be identified explicitly – even if they were not always made explicit at the time. The change from the 1950s to post-2000 is marked by the transition from state-sponsored to individually initiated investment arbitration, by modern arbitral jurisprudence and by the overwhelming role of investment treaties – as compared to customary international law. Not all of the quite general statements of the period – including the formulation of the resulting pacta sunt servanda clauses – can therefore be automatically applied to the quite different, contemporary context.

The evolution of both the debate on the principle of pacta sunt servanda in customary international law and its anchoring in investment treaties in the form of the "pacta sunt servanda/umbrella" clause, suggests that disputes over contracts that display merely commercial and contract law elements will not fall under international law; such disputes do not involve the power of government which is the target of customary international law and even more the external

---

[18] *Ref: CHECK Sinclair*

disciplining intention of investment treaties. They should be determined by the applicable (generally, though not always, domestic law) and by domestic courts or arbitral tribunals set up by contract. It is only when such domestic courts abuse their normal adjudicatory powers ("denial of justice" and lack of "due process") that international law comes into play[19].

Contracts, on the other hand, where the contract itself, and in particular the alleged breach and pertinent dispute, involves the state not, in traditional language as the "fisc", but rather as the sovereign state, with its regulatory, administrative and political power in operation, tend to be seen as more suitable for international disciplines. It is here both the nature of the contractual relationship and the focus on the particular and incriminated governmental conduct at issue which requires qualification. It may make sense to operate – as in other cognate areas of investment law a rebuttable presumption that the qualification of a contractual relationship as at least partly governmental and not "merely commercial" suggests that also the breach, i.e. the end point of the relationship, should be qualified as governmental[20].

The reliance of the criterium of "merely commercial" versus "governmental" is very similar, for good reasons, for the criteria used to attribute state enterprise conduct to the state – as in the recent

---

[19] *F.A. Mann, supra; Azinian v. Mexico, 1999; Jan Paulsson is preparing a study on denial of justice in international investment law; references to this principle also in Mondev v US,*

[20] *Presumptions and burden of proof is extensively used by international tribunals for a variety of reasons: Partly they help to manage in itself not absolutely clear and complete information, partly they apply a probabilistic and plausibility judgement and partly and perhaps most importantly they put some of the burden of loss on the losing party itself. The ECJ – e.g. EU Commission v. France et. Al. 1997 (energy export monopoly) – has employed the burden of proof mechanism for precisely the same reasons. In investment arbitration, it is in particular with respect to the following issues that tribunals have successfully operated burden-of-proof and prima facie proof mechanisms: Attribution of state enterprise conduct to the state (structural test of state control gives rise of presumption that conduct at issue is functionally a public matter and should be attributed to the state (Maffezini, Salini, Boeckstiegel, op. cit infra) and with respect to discrimination (distinct treatment of prima facie like situations requires state to prove that situations are not alike and/or that distinct treatment is based on legitimate reasons – WTO cases of alcoholic beverages; asbestos case; Myers v. Canada and Feldman Karpa v. Mexico case; Nykomb v. Latvia case). G Verhoosel, National Treatment and WTO Dispute Settlement, Hart Publishing 2002. A legal opinion by Prof. C. D. Ehlermann has been used both in the Methanex v. US and the Nykomb v. Latvia cases.*

Maffezini I and II and Salini cases[21]. In both cases, the issue is to discipline the state when it uses – and always at least allegedly abuses – its governmental powers for getting out of a contract with a foreign investor/trader. If it is "merely commercial", there is no reason to treat the state differently from non-state operators involved in commercial disputes. This is similar to WTO and ECJ jurisprudence where WTO and EU competition law is not deployed to control state enterprises and agencies' conduct if these comply with a "business judgement test", e.g. behave as if they were private, profit-motivated commercial operators[22]. Sometimes, the commercial versus governmental test seems to be replaced rather by a focus on the "abuse" of government powers which is contrasted with the "legitimate use of police powers"[23]. But both tests are rather complementary than contradictory: In a purely commercial situation where the dispute turns about "normal" contract law, unabused and un-manipulated by government, the government can not be described as "abusing" its government powers[24]. If the contractual dispute is coloured by the use of government powers to revoke or substantially modify in its favour a pre-existing contract, then a further distinction between "legitimate" use of government power and abuse of such powers comes into play. It is actually a two-step test that starts with the commercial versus governmental nature of the alleged breach and then moves to the test if the government merely uses legitimately its powers in a general and not discriminatory way, not specifically targeting the foreign investor and not specifically trying to escape its otherwise solid contractual commitment or if the reliance of government powers to get out of

---

[21] Most detailed: Boeckstiegel, Der Staats als Vertragspartner auslaendischer Privatunternehmen, with an English follow-up study published in 1984; Maffezini I and II v. Spain and Salini v. Morocco have been published on www.worldbank.org/icsid and published and commented in Clunet/ JDI 2003.

[22] P.J. Slot, Regulation of prices in the energy sector in the EC, Manuscript 1997; see both the Dutch horticulturalists (van der Kooy) and the Cofaz cases: Commission decision 83/215; Court decisions: 1988 ECR 2129
Cofaz I, 1986 ECR 408; Commission decision: OJ 1992 C 344/4; Cofaz II: case 169/84; Altmark decision, C-280/00 of July 2003; 2004 book on EU state aids

[23] Francis Mann, 1960 op. cit. supra; on the exposure of contracts to state police powers also: Gesellschaft, Heft 2, 1958, p. 32 (Introduction to draft Abs Convention).

[24] There may, though, be an use of dominant private economic power which usually triggers the application of competition law (Art. 1 US Sherman Act; Art. 82 EU Treaty. There could be an argument that a treaty should apply to the abuse of dominant private economic power or to privately organised, but government-owned economic power, but here the reason to identify a governmental dimension and attribute the power to the government would be the government's duty to exercise its powers – ownership, control or regulation – to prevent abuse by dominant economic power.

commitment now seen as onerous has elements of abuse. The two-step test lends itself to a burden of proof allocation whereby a government that deploys its governmental powers and prerogatives to get out of burdensome contractual commitment has to prove that the exercise of such powers is general, not targeted at the particular contract, legitimate and not abusive. The specific disciplines of investment treaties – "fair and equitable", "constant protection", non-discrimination and expropriation (including indirectly by regulatory taking) allow to take into account the elements of good-faith and abuse of right[25].

It is before this background one has to understand the emergence of the clause at issue in the SGS v Pakistan and SGS v Philippines awards. BIT practice can be much explained by its function to provide a legally binding alternative to the advocacy of absolute sovereignty propounded by the "New International Economic Order", its legal instruments (mainly UN General Assembly resolutions of 1974) and its proponents[26]. While the forerunners – the Abs, Shawcross, Abs-Shawcross and OECD draft conventions were reactions to the nationalisations of the 1950s and the nationalist legal argument made by the respondent states in the arbitrations of the 1950s, the BITs since the 1980s were a response to the "NIEO" legal positions then staked. The perhaps high-point of arbitral jurisprudence at the time, the Texaco/Calasiatic v. Libya award,[27] developed a principle of international law protection – without particular stipulation in the applicable law clause – for concession contracts against governmental abrogation. This case was at the time – and still recently – contested, in particular from the absolute sovereignty perspective of the "NIEO"[28]. BIT practice was then intentionally developed into an instrument to counter these NIEO positions; it was meant to reinforce, and where possible extend, the concept of extensive protection of contracts of foreign investors with governments – much in the sense of the Texaco v Libya award, against its criticism and the formulation of the alternative NIEO positions of absolute sovereignty[29]. The introduction of the "umbrella" clause" into the first (German) BITs, into the Abs &

---

[25] *On good-faith and abuse of right: Bin Cheng, General Principles of Law, Grotius, Cambridge, 123 et seq.*

[26] *Waelde, Requiem for the New International Economic Order, in: Festschrift fuer Ignaz Seidl-Hohenveldern, 1998, Kluwer, London*

[27] *53 ILR (1979)389*

[28] *M. Sornarajah, 1994, International Law of Foreign Investment*

[29] *E. Denza and S. Brooks, Investment Protection Treaties: UK Experience, 36 ICQL 908 (1987); R. Scott Gudgeon, Arbitration Provisions of US Bilateral Investment Treaties, in: S. Rubin/R. Nelson, Internatioanl INvestment Disputes: Avoidance and Settlement, West Publishing St Paul, 1985, 41*

Shawcross projects, the OECD models I and finally into more general BIT practice[30] can perhaps be seen as the translation of the – from a Third World perspective much contested – Texaco/Calasiatic v. Libya principle into state practice. It is not unknown that principles developed in judicial decisions are then reflected in subsequent treaties, either by incorporation or by explicit reject[31]. It is here that the idea developed that an additional, explicit reinforcement of the duty to respect contracts with foreign investors would be desirable. The precursor of such clauses was the "stabilisation" clause that had existed for quite a while and was re-introduced into concession and related contracts to protect a contract from abrogation or other negative interference by subsequent national law[32].

History and Occurrence of the Umbrella Clause[33]

As we have seen, the issue of "pacta sunt servanda", applied to (foreign-direct) investment-related contracts (then typically in the form of public-private law concession agreements) was very much in the mind of international economic and financial lawyers in the 1950s. Against the contrast of nationalist and socialist takings of property and revocation of long-term investment agreements post WW II, with a

---

[30] US FCN treaties did (apart from the 1949 US-Ethiopia treaty not include pacta sunt servanda clauses. Alenfeld, p. 104, FN 210, suggests with reference to a 1963 ABA report (p. 28) that the US felt such clause would have limited its "eminent domain" powers. But US and UK BITs from the 1980s onwards, as a rule and where accepted by the other state, contain this clause, e.g. the 1992 US-Argentina BIT, 31 ILM 124 (1992)

[31] Schwarzenberger, infra, suggests that the first occurrence of the clause in Art. II of the Abs-Shawcross model convention was meant to reject the Iranian argument in the Anglo-Iranian oil case that an assurance given on the level of domestic level did not amount to a commitment under international law, p. 160. For example, some of the libertarian positions taken by the Pope-Talbot v. Canada award and the comparable Myers v Canada award seem to have led to the 2001 NAFTA parties interpretative decision purporting to restrict the "fair and equitable" concept to the traditional minimum standard in international law, but also to similar restrictive formulations in subsequent US Foreign Trade Agreement practice (as illustrated by the US-Chile and US-Singapore FTA, see: D. Gantz, Contrasting Key Investment Provisions of the NAFTA with the United States - Chile FTA, in: T. Weiler, NAFTA Investment Arbitration, 2004 (forthcoming)

[32] Waelde, T., and Ndi, G., 'Stabilising International Investment Commitments', 31 Tex. Int'lL.J. 215 (1996); Charles Leben, Quelques reflexions theoriques a proposes des contrats d?etat, from: Melanges Philippe Kahn: Soverainete etatique et marches internationaux, 30 ans de recherche du credimi, vol. 20 travaux de Credimi, 2000

[33] I rely here very much on Anthony Sinclair's concurrent examination of the history of the "pacta sunt servanda" clause, a project I suggested and in which we have both communicated intensively, The origins of the umbrella clause in early international investment protection codes, forthcoming in: J of World Investment , 2004

recollection of similar cases in the inter-War period justified by the concept of complete and exclusive subjection of such agreements to domestic law and governmental powers in the sense of the Calvo-doctrine, they developed the idea that there should be an international law protection of such contracts. In the minds of the time, such protection should be rather by treaties – less controvertible and ambiguous than always disputed principles of customary international law; protection against un-compensated expropriation was the key issue – long-term investment contracts were seen as a subset of the protection of proprietary rights against un-compensated expropriation. The protection of both was then – as earlier and as again now – seen as an essential condition for achieving properity by international trade, investment and economic integration. The unfinished business of the Havana Charter's investment chapter – i.e. the need to add to the trade and finance pillars of the Bretton-Woods international economic law an investment pillar – played a role. While "good-governance" was then not used as a formal term, the liberal international lawyers of the time connected good-governance with economic development, prosperity and an international order for what we might now call the "global economy" much as we do now. They did not only see protection of foreign investment exclusively in the sense of the home state making a reciprocal aliens' protection deal as was the traditional notion of intergovernmental agreements, but also as a contribution to good-governance for the developing countries then emerging from decolonisation and for all countries emerging from the ravages of World War II[34]. Their endeavour was oriented towards both much clearer international norms and institutions and procedures (later to become the 1966 ICSID Convention) to apply such norms on the level of international law. It is in this context that the "pacta sunt servanda" clause (or "umbrella clause[35]" or "Abschirmungsklausel") emerged. While we have not pinpointed exactly and to the last degree the

---

[34] This is very clear from Abs, Internationale Probleme und Fragen der Investitionsfinanzierung, in: Gesellschaft, Heft 2, 1958, 7-17; Shawcross, Die Foerderung internationaler Investitionen, Rede vor der Gesellschaft zur Foerderung des Schutzes von Auslandsinvestitionen in Koeln am 7. Dezember 1959, in: Gesellschaft, Heft 3, 1960, 49-67

[35] It seems to me that "umbrella" clause is not the best term. Prosper Weil – from whose 1969 Recueil des Cours, p. 130-135 – many derive the label, spoke of "traite de couverture" – "treaty of coverage" – rather than of "umbrella clauses". The term "umbrella clause" does not convey the same meaning as "traite de couverture" nor does the German term – "Abschirmungsklausel" (some indications are that the term was first used in German and translated into English as "umbrella" clause by Ignaz Seidl-Hohenveldern, the chairman of the then ILA committee on expropriation. The German term suggests rather the sense of "protection against" (expropriatory measures) than "umbrella" in the sense of a higher-level protective legal instrument.

ultimate origin, Anthony Sinclair's research in documents of the period and interviews with survivors of that period suggest the formation of the "pacta sunt servanda" clause came about as follows:

While there were antecedents in the use of bilateral treaties to give coverage to state contracts, and while the 1949 US-Ethiopia FCN contained exceptionally something akin to the current pacta sunt servanda clause, the clause properly emerged in the context of the Abs-Doelle (German), Shawcross (British) and in particular in the subsequent joint Abs-Shawcross model investment conventions at the end of the 1950s. Sinclair's painstaking research and interviews suggest that Eli Lauterpacht, in legal advice to the Anglo-Iranian Oil Company on the settlement of their dispute with Iran and on a Iraq pipeline agreement, suggested the use of an intergovernmental treaty on the international level above the project contract to both internationalise the contracts' obligation and to provide a state-to-state jurisdiction (here the International Court of Justice). This internationalisation was then – as it was in the 1970s and at present – a means to counter the legal positions that such contracts were exclusively anchored in and subject to domestic law, and thus exposed to legislative revocation by the host state[36].

The first occurrence of the "umbrella" clause as a distinct investment protection mechanism in a formal (though not legally binding) document could be seen in Art. IV (4) of the Abs-Doelle Draft of 1958:

> *"In so far as better treatment is promised to non-nationals than to nationals either under inter-governmental <u>or other agreements</u>… such promises shall prevail"*[37]*- and*

Art. IV also guarantees the freedom with respect to acquisition, management and enjoyment of assets, rights and interests which can

---

[36] *See the more detailed analysis by Sinclair, at notes 42 et seq; Schwarzenberger, 1969, p. 160; it is interesting to note that the British and the German efforts at a model investment convention referred to quite different cases: In the British case, it is in particular the Anglo-Iranian concession dispute (revocation under the Mossadegh-government), in the German case it is – apart from Mexican oil, Argentine electricity, the Suez canal and other mainly East European (i.e. Communist) concession disputes – mainly disputes post WW I with Poland and WW II with Czechoslovakia which form the backdrop to the – in the end – joint Abs-Shawcross convention. Gesellschaft, op. cit., Heft 2, 1958, pp. 27-31; Seidl-Hohenveldern, Internationales Konfiskations- und Enteignungsrecht, 1952.*

[37] *H.J. Abs, The safety of capital in Bruchley/Daniel (Eds) Private Infvestment, 1980, 69; in German: Gesellschaft, 1958, Heft 2, p. 46*

not be limited, directly or indirectly, by statute regulation, administrative measure or otherwise if such action would result *in :*

> *(Art. 4, 3, d): "a restriction or revocation of concessions…"*[38]

This approach combined with a formulation in the Shawcross model developed into in Art. II of the 1960 Abs-Shawcross Convention of 1959[39]

> *"Each Party shall at all times ensure the observance of any undertakings which it may have given in relation to investments made by nationals of any other Party"*

This "model" formulation – together with the simultaneous appearance of the clause in the first (German) BIT with Pakistan:

> *Art. 7: Either party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other party".*

marks the emergence of the pacta sunt servanda clause in formal – and in the case of investment treaties binding – international investment law. It was followed by the Art. 11 of the OECD Draft Convention of 1963 amended in 1967:

> *"Each party shall at all times ensure the observance of undertakings given by it in relation to property of nationals of any other party"*[40]*.*

The notes and comments make, as demonstrated by Alexandrov,[41] clear that the drafters considered the breach of a contract with a

---

[38] *Gesellschaft, Heft 2, at p. 46, commentary at p./ 58, 59; I have translated the relevant parts of the text. There is also a possibly significant reference to national treatment which is ambiguous (not clear if compliance with national treatment provides an exception for the cancellation and restriction of concessions. Concessions are earlier defined as based on public-law (e.g. the civil law concept of "contrat administrative". They are protected if they are "backed" by investment and then acquire the status of protected acquired rights. The protection contains elements of "legitimate, investment-backed" expectations, abuse of right, venire contra factum proprium and good faith.*

[39] *As cited and discussed in G. Schwarzenberger, Foreign Investments and International Law, 1969, 116 and 160.*

[40] *2 ILM 241 (1963), for amended version: 7 ILM 118 (1968).. Prosper Weil, infra, p. 131 makes reference to a related clause in the 1963 French-Tunisian investment treaty, though the text of this provision does not contain the same explicitness about a contractual commitment being covered by the Treaty.*

[41] *supra*

foreign investor as an international tort; Art. 11 of the OECD Draft Convention was therefore seen as merely codifying the pre-existing state of customary international law. The distinction between "purely commercial" contract disputes and investment-related contract disputes seems not to have been explicitly employed, perhaps because the OECD Convention's general intention and scope focused only on investment-related contracts so that a separate distinction would have been unnecessary. Contracts related to investment – at this time seen in a much more narrow way as "foreign direct investment" than today – did by their very nature always involve a governmental dimension. Treaties at this time also only provided for state-to-state arbitration; this provided a screening mechanism against exorbitant and gratuitous use of treaties by private commercial operators. The response of the US Section of the ILA to the ILA expropriation committee questionnaire[42] emphasised that a revocation of contracts constituted expropriation; it found a breach of international if the state departed from its role as contract party and, by reference to its sovereign power, destroyed the expectation of contract compliance. Similarly, Lord Shawcross[43] noted that the (now joint Abs-Shawcross) convention aimed at "Staatsakte" – acts by the state as state, and not at conduct by private persons. These references and the overall context (revocation of primarily concession agreements) suggest that the fathers of the "pacta sunt servanda" clause assumed as evident that the state conduct targeted by the clause had to be qualified as "governmental". The idea that any commercial contract concluded by state entities in their "fisc", i.e. private-law role, did not occur to them – and was therefore not debated. It was large, long-term investment-backed semi-public concession contracts that were then in the eye of the international law constituencies; the risk to be managed was expropriatory action – and the pacta sunt servanda clause was seen as a special expression of the prohibition on non-compensated expropriation. The question raised by the SGS / Pakistan and SGS/Philippines tribunal in 2003 if "any" contract was covered by the clause was then not an issue – and the clause as then formulated was not targeting purely commercial interaction without any distinct feature of governmental powers and prerogatives present.

---

[42] *Gesellschaft, Heft 3, 1960, p. 100 101*

[43] *Lecture to the Abs-Doelle Committee, in: Gesellschaft, Heft 3, 1960, p.; 60, 61*

Prosper Weil[44] presented and further developed in 1969, in his Hague lecture, the idea that an investment treaty would transform a mere contractual obligation between state and investor into an international law obligation, in particular if the treaty included a clause obliging the state to respect such contract. The Treaty's umbrella clause (or, as I would prefer to call it, "sanctity of contract" or "pacta sunt servanda" clause) thus replaces the need to negotiate in the contract with the host state an internationalisation regime consisting of stabilisation, arbitration and international law clause. Modern investment treaties have further developed this approach. They include methods of property and contract protection which individual investors, in an often more difficult negotiating context, might not have been able to negotiate on their own. The prime example is the innovation of investor arbitration based purely on treaty, and no longer requiring a specific arbitration agreement. The "umbrella" or "pacta sunt servanda/sanctity of contract" clauses are therefore part of this policy led by bilateral, and later multilateral investment treaties (here mainly the Energy Charter Treaty, Art. 10, 1, last sentence) to both counter the NIEO assertions of unfettered sovereignty over governmental commitments and to develop the not fully settled state of international law "progressively" towards greater coverage of contracts with government. They also codify the earlier – and unanimously accepted – principle articulated by the UN General Assembly in 1992 that

> *"investment agreements freely entered into .. by sovereign states shall be observed in good faith"*

rather than the subsequent anti-investment positions of the NIEO resolutions[45]. While the specific meaning of such clauses is still not easy to ascertain, it is evident that such clauses were meant to add something to the protection otherwise enjoyed by contracts by investors with governments under customary international law and the earlier investment disciplines. They are meant to "give investment contracts with states special protection"[46] and indicate the applicability of "pacta sunt servanda" as an international law principle applicable not only to treaties, but also to investment contracts between private investors and foreign states solving here again a classical controversy

---

[44] *P. WEIL, Problemes relatifs aux contrats passes entre un etat et un particulier Recueil des Cours III 1969 pp. 132 et seq. ; idem, Droit international et contrats d'Etat, In Melanges offerts à Paul Reuter, Pedone 1981, p. 549-582; see also: David (N.), Les clauses de stabilisation dans les contrats petroliers, Journal du droit international 1986, p. 79.*

[45] *See Paasivirta, Energy Charter Treaty and Investment Contracts, in: T. Wälde, Energy Charter Treaty (1996) at p. 358 and 359*

[46] *Paasivirta, supra, 358*

by "progressive codification" in the sense of greater protection of investors[47]. There seems to have been no doubt in the mind of contemporary observers that the effect of the clause in an investment treaty was to transform what might have been an obligation, arguably for some only under domestic law, into a justiciable obligation under the international law of the treaty[48]. But it is important to note here again that the overall treaty context has progressed significantly from the 1960s: If the proposals of this period envisaged a treaty focusing on the protection of mainly "foreign direct investment", with a filtering and sponsoring function by inter-governmental arbitration, modern investment treaties protect not only "direct investment" in the conventional sense, but essentially all proprietary rights of a financial value ("all assets")[49]; in addition, the filtering function by way of required home state sponsorship of claims is gone. Any person plausibly claiming to be an investor under the Treaty can now claim for breach of the broad disciplines against its very broadly defined assets. The question is: Does this change of context in the Treaty nature also affect the "pacta sunt servanda" clause – in the sense of requiring a different concept of what obligations are covered by it?

With its first properly legal appearance in the German-Pakistan BITs and in the widely used OECD models, the pacta sunt servanda clause started to be a regular feature of most BITs, entering later also into the US and UK models. It is, however, not present in Chapter XI of the NAFTA; contract protection needs to be dealt with under the principles of expropriation and, under the "fair and equitable heading", by the principle of legitimate, investment-backed expectations (or

---

[47] *So also Dolzer/Stevens, Bilateral Investment Treaties, 1995 82; they seem to envisage the clause to cover both "simple breach of contract" and interference by administrative and legislative acts. They have no doubt that "obligations" cover obligations arising from investment contracts, with reference also to Bowett, State Contracts with Aliens, 59 BYBIL 88 (1992)*

[48] *Schwarzenberger, supra, 116, 160. Schwarzenberger also suggests that the clause clarifies that no exhaustion of domestic remedies was necessary – a position confirmed in the investor-state arbitration provisions of modern investment treaties. He does, though – pp. 161 and 159 – suggest that contract law principles – non-performance, force majeure – need to be made applicable. Our distinction between "commercial-only" contracts and contracts with a governmental dimension is otherwise not present in such older writing, possibly because they all envisaged "investment contracts" between state and investor, and not purely commercial contracts. Also, since in older investment law the home state had the exclusive right to sponsor a claim by one of its investors, there was an additional restrictive "valve" controlling the type of claims raised, something that is not present in modern situations where the investor on its own can decide to raise a claim.*

[49] *Noah Rubins,* The Notion of Investment in International Investment Arbitration, in: N. Horn (Ed), Investment Arbitration (approx. title, 2004 forthcoming)

"detrimental reliance")[50]. Nor is it present in the new US model foreign trade agreement of 2004. The original US reluctance – overcome in the US model of the 1980s and 1990s[51] – seems to have re-emerged. The MAI text provides – in the annex, listing negotiating proposals – two formulations proposed for a "respect" clause[52]. No formal count has been carried out, but it is likely that the majority of BITs, in particularly of relatively recent date, includes a pacta sunt servanda clause.[53]

There were situations where the host state objected and the proposition to include a pacta sunt servanda clause in a BIT was dropped[54]. As it was – before the Fedax and mainly before the two 2003 SGS cases – never tested, the discussion of the clause in the relevant literature are as a rule speculative and theoretical[55]. The distinction between breaches on the level of "normal" contract law and on the level of international law, involving some sort of abusive or excessive governmental interference, was never defined or thought through fully, though it plays a role in F.A. Mann's analysis, in the extensive reference to contract law principles and remedies (mainly rebus sic stantibus) in Alenfeld's discussion[56] and references in BITs to the coverage by this clause of obligations assumed related to the "exercise of governmental power"[57]. Alenfeld's discussion of the pacta sunt servanda clause in German BITs seems to assume again[58] that the clause protects against "governmental interference"[59], though other authors mention (though usually without an in-depth

---

[50] Tecmed v. Mexico, 43 ILM 133 (2004)
[51] E.g. amongst many others the 1995 US-Latvia BIT
[52] MAI draft, p. 104, country-specific proposals:
"Each Contracting Party shall observe any other obligation in writing, it has assumed with regard to investments in its territory by investors of another Contracting Party. Disputes arising from such obligations shall only be settled under the terms of the contracts underlying the obligations".
And:
RESPECT CLAUSE
"Each Contracting Party shall observe any obligation it has entered into with regard to a specific investment of an investor of another Contracting Party".
[53] Unctad, BITs in the mid-1990s,l pp. 54-56
[54] Alenfeld, 104, FN 210 reports that Chile refused to accept in its then BIT with Germany the pacta sunt servanda clause included in the standard German BIT proposal.
[55] Mainly F.A. Mann; Alenfeld, 1971, p. 99-104; Weil, 1969 and op. cit. supra;
[56] Alenfeld, 1971, 102, 103
[57] Note the Protocol, No. 8 to the German-Turkish BIT quoted in Alenfeld, p. 98
[58] at p. 104
[59] Alenfeld, p. 97, 100 suggests that the clause can be read as a "waiver" of otherwise available governmental powers to revoke the contract or restrict it in the public interest.

examination) that it should also cover "mere" or "simple" breaches[60]. The view that the clause only targets the use (and possibly only abuse) of governmental powers directed against contracts would conform with what seems to be the majority view with respect to the treatment of contract breaches in customary international law[61]; the view that it covers "any" or "simple" or "commercial" breaches[62], on the other hand, is likely to imply a significant expansion of the scope of the clause. While compatible with the formulation in most pacta sunt servanda clauses,[63] it is not what the inventors of this clause had in mind when they drafted it in the 1950s to counter governmental abrogation or excessive limitation of mainly concession contracts.

The precise scope of such coverage and the specific meaning of the now numerous, if not pervasive "umbrella" clauses in modern investment treaties has as yet not been tested. Tribunals will often prefer to decide for reasons of judicial economy and to avoid more assailable reasons rather on established grounds (discrimination, fair and equitable, indirect expropriation) than on the grounds of the umbrella clause. In fact, the first Energy Charter Treaty award rendered in 2003 could have rendered its judgement on the basis of Art. 10 (1, last sentence) of the ECT as was proposed by the claimant and contested with respect to its scope by the respondent; it preferred – understandably – to rest its award in favour of the claimant rather on the much more developed concept of discriminatory treatment[64],

---

[60] *F.; A. Mann, British Treaties for the promotion and protection of investments, 52 BYIL 24, 246 (1981); Dolzer/Stevens, Bilateral investment treaties, 1995, p. 81, 82.*

[61] *Note only: "A state is only directly responsible, on the international plane, for acts involving breaches of contract where the breach is not a simple breach .. but involves an obviously arbitrary or tortuous element" and with respect to the earlier Norwegian loans case : "Lauterpacht would have considered that a failure by a government to honour a gold clause in a contract with a foreigner involved a sufficiently tortuous element to bring the case within the above mentioned principle". Gerald Fitzmaurice, Hersch Lauterpacht, XXXVII BYBKIL 1961, 64-65*
And:
" the breach of such a contract by a state in ordinary commercial intercourse is not, in the predominant view, a violation of international law, but the use of sovereignty authority of a state, contrary to the expectations of the parties, to abrogate or violate a contract with an alien is a violation in international law"
S. Schwebel, 1987, op. cit. 409 et seq.

[62] As seems to have been suggested by claimant in the SGS v Pakistan and SGS v Philippines cases, infra

[63] E.g. "shall observe any obligations it has entered into with an investor or an investment of an investor.." in Art. 10 (1) Energy Charter Treaty.

[64] *The award Nykomb v. Latvia has been briefly reported in the SD-Invest Newsletter of December 2003 and in the Latvian press; an article by Kaj Hober, published in OGEL 5 (2003) at www.gasandoil.com/ogel discusses the factual background and*

though it did acknowledge the possible applicability of the other causes of action (including the pacta sunt servanda clause of Art. 10 (1, last sentence) ECT. Given the now very frequent occurrence of the pacta sunt servanda/umbrella clause in modern investment treaties[65], it is high time that this well-established investment discipline gets properly analysed, argued, tested and developed in arbitration. It is for these reasons that an analysis and critique of the treatment of the clause in the jurisdictional awards SGS v. Pakistan and SGS v Philippines is called for.

The SGS v Pakistan award

This jurisdictional award[66] (F. Feliciano, C. Thomas, A. Faures) deals with a contract obtained by SGS for customs inspection in Pakistan. The current Pakistan government claims it has been obtained by bribery, and there has been an on-going anti-bribery prosecution in Geneva against former Prime Minister Benazir Bhutto. The government repudiated the contract. SGS, after an unsuccessful litigation in Geneva, raised a claim against the government under the Swiss-Pakistan BIT; the government raised a counter-claim under the contract's arbitration clause against SGS in Pakistan. This contractual arbitration mechanism is unfavourable to SGS – the Pakistan Supreme Court has to appoint the sole arbitrator; it did appoint a retired Supreme Court Judge. The Supreme Court of Pakistan ordered SGS to comply with the contractual arbitration clause and enjoined it from continuing with the ICSID, BIT-based arbitration (published in a previous issue of ILM, 2003). The domestic arbitration has, so far, been stayed by the sole arbitrator. The award deals with the complex relationship between treaty-based and contract-based arbitration over substantially the same factual situation[67]. It further deals with the

---

early legal argument. Under the rules of the Stockholm Chamber of Commerce it is not publicly available.

[65] I estimate that most modern BITs based on the US and UK model (followed by many other countries as well) now include an umbrella/sanctity clause, so also the tentative view of UNCTAD: UNCTAD, "Bilateral Investment Treaties in the Mid-1990s" (New York and Geneva: United Nations, 1998, pp. 52-54. NAFTA, it has to be emphasised, does not include this clause. Contract reliance issues are dealt with in NAFTA awards by reading the concept of "detrimental reliance" or "disappointment of legitimate expectation" into the "fair and equitable" treatment obligation of Art. 1105 (1), see: Techmed v. Mexico; Metalclad v. Mexico, available at www.naftaclaims.com

[66] I understand that the case by go, by early 2004, to settlement.

[67] This conflict between contract-based and Treaty-based arbitration was identified in the – then only theoretical – discussion of the then very new investment arbitration facility under the ECT in my article: Investment Arbitration under the Energy Charter Treaty: 12 Arbitration International, 429-467 (1996); see also: 29 J World Trade, 5 (1995); see also the simultaneously written analysis by Genevieve Burdeau,

question of the relationship between a contract claim (under domestic law) and an investment-treaty claim[68], an issue that has occupied several other recent tribunals (CMS v Argentina; Salini v Morocco; Maffezini v. Spain; TRADEX v Albania; CME v. Czech; Sandline v PNG; Yaung Chi Oh v. Myanma[69]r; Wena v. Egypt; Czech Obchodni Bank v Slovak Rrepublic; Lanco v. Argentina; Azinian v. Mexico) and authoritatively decided in the Vivendi v. Argentina annulment decision[70]. It is also the first award where an "umbrella" (Prosper Weil) or "pacta sunt servanda" provision[71], i.e. a clause spelling out explicitly an obligation of the government to respect its commitments, was, for the first time, discussed in detail. In the earlier Fedax v. Venezuela case[72] (of which the tribunal seems to have been unaware), the clause was relied upon and applied to a promissory note contract, but the tribunal did not carry out any in-depth examination of the clause or its application. It simply applied its "plain meaning", that

---

Nouvelles Perspectives pour l'arbitrage, dans le contentieux economique interessant les etats, Rev de l'arbitrage, 1995, 2-37 which also identifies the jurisdictional conflicts raised by the new direct investor-state (without explicit agreement) arbitration mechanism

[68] On this: B. Cremades, 2004, op. cit.

[69] Case comments by E. Gaillard on the Yaung Chih Oh case and the Vivendi annulment was published in OGEL 4 (2003) at www.gasandoil.com/ogel

[70] 41 International Legal Materials 1135-1163 (2002); also at www.worldbank.org/icsid)

[71] I understand that Prof Prosper Weil – in Recueil des Cours, 1969, op.cit. supra – was the first to refer to "umbrella clauses" and "umbrella treaties" ("clause parapluie"). I have used (with G. N'di, Texas J IL 1996, op. cit. supra) rather the term "pacta sunt servanda" or "sanctity of contract" clause, referring to the terms used also in the crucial Texaco-Calasiatic v. Libya (supra) award which seems to have given at least impetus to the formulation of such clauses in investment treaties. See also: Esa Paasivirta, The energy Charter Treaty and investment contracts, in: T. Waelde (Ed) The Energy Charter Treaty, Kluwer 1996, 349-365 and: Paasivirta, E., "Internationalisation and Stabilisation of Contracts versus State Sovereignty", 60 BYIL 342 (1989); Nagla Nassar, Sanctity of contracts revisited: A Study in the theory and practice of long-term international commercial transactions, Nijhoff, Dordrecht 1995. Umbrellla clauses are also discussed in Dr Benhamida's forthcoming book on "Arbitrage Transnationale", supra. UNCTAD – BITs in the mid-1990s (1998), supra – refers to the increasing frequency of occurrence of such clauses in BITs, an observation any BIT practitioner will be able to confirm by experience, but it does not seem to have identified any particular problem with respect to application of such clauses to contractual commitments; the UNCTAD study – usually written from a developing country viewpoint – certainly did not propose or even raise the possibility that umbrella/sanctity clauses could in the end mean, as the SGS v Pakistan tribunal speculated, a good-will obligation to carry out domestic regulatory reform or a protection of arbitration agreements concluded by investors with governments against domestic court injunctions.

[72] A comment on the Fedax case: Investment-Related Promissory Notes Are Investments under the Icsid Convention_Fedax N.V. v. The Republic of Venezuela, C. Chatterjee, in: 3 J World Investment, 147 (2002)

commitments should be observed under the BIT, to the promissory note contractual document. This comment will focus on the tribunal's treatment of the pacta sunt servanda clause in the Swiss-Pakistan BIT.

The tribunal assumed jurisdiction – as did all other tribunals quoted – over the relationship in spite of the existence of a domestic-law contract with an exclusive domestic arbitration clause. It considered the contract an "investment" in the sense of the BIT and Art. 25 of the ICSID convention – which is consistent with the recent Salini v Morocco decision[73]. In doing so, it relied on the qualification of the contractual relationship as not "simply commercial", but vested with a "iure imperii" character, i.e. a public-law concession. Relying mainly on the now authoritative Vivendi annulment decision[74], it viewed the BIT claims as reasonably distinct from contract claims as the Treaty laid down an independent standard to judge the conduct of the parties. In essence, it assumed there was a concurrent jurisdiction – the domestic arbitration on the contract under domestic law, the ICSID tribunal on the conduct of the parties under the BIT-standards. There was no litispendence: The factual situation may have been the same, but the applicable law was on one side domestic law, on the other the BIT. The existence of a state-investor contractual arrangement can not effect the legal qualification of his claim on the international level[75]. This part of the tribunal's reasoning is in line with the evolving general jurisprudence. Any other solution would allow governments to use an exclusive jurisdiction clause in favour of domestic courts to make investors waive the Treaty protection. Reportedly, some countries in Central Asia have in fact tried to obtain, after losing arbitration cases, from investors written waivers of IT-rights available. That was and is against the explicit underlying policy of investment treaties – the right to protection can not be waived by individual investors – as earlier

---

[73] *Discussed, inter alia, by and E. Gaillard, Chronique des sentences arbitrales,CIRDI, in: 130 Clunet/JDI 162-259 (2003).*

[75] *See on this also the Vivendi annulment, para 101-102; see also Kurt Lipstein, The place of the calvo clause in international law, 22 BYIL 130 (1945). This does not mean that some interaction between domestic law and international law is impossible: Claimant rights protected by international law are created primarily by domestic law, even if domestic law is controlled internationally from un-making such rights abusively. Similarly, procedural actions under domestic law – e.g. recourse to domestic courts – can be judged under international law concepts such as denial of justice. Also, compensation due under international law will be influenced by damages paid under domestic law – otherwise there could be double recovery.*

discussions of the validity of Calvo-clause type of waivers of diplomatic and treaty protection had indicated much earlier[76].

The interesting – and problematic – part of the award and this comment, however, lies in its outright rejection of the applicability of the "pacta sunt servanda/umbrella" clause to contracts concluded with the government – even, as here, of an incontrovertibly "administrative law" character ("contrat administratif"). The outright rejection to apply the literal text and plain meaning of the clause in the Swiss-Pakistani BIT recalls the similarly outright rejection of the "plain meaning" approach applied to the "fair and equitable standard" advocated by J. C. Thomas, one of the arbitrators in the SGS v Pakistan case, in a recent article[77].

Before reviewing the arguments used by the tribunal to reject (almost) any thought of the practical applicability of this clause, we have to recall the recent, widespread practice of such relatively recently emerged clauses in investment treaties, and also their underlying rationale and purpose[78]. Art. 10 (1, last sentence) of the Energy Charter Treaty provides perhaps the best example of this clause as it is repeated in many if not most US and UK-based recent BITs, but also many others inspired by these lead models:

> "Each Contracting Party shall observe any obligations it has entered into with an investor or an investment of an investor of any other Contracting Party".

This clause – possibly of an even wider scope than the clause used in the Swiss-Pakistan BIT at issue in the SGS award – is conspicuous by its width of scope: It is "<u>any"</u> obligation which requires observance,

---

[76] *Kurt Lipstein, The place of the calvo clause in international law, 22 BYIL 130 (1945); R. Scott Gudgeon, op. cit. supra and idem, Scott Gudgeon, US Bilteral investment treaties, in: Int'l Tax &*
Business Lawyer 105 (1986)

[77] *Thomas J.C., "Reflections on Article 1105 of Nafta:History, State Practice and Influence of Commentators" Icsid Review, Foreign Investment Law Journal Vol.17, No1, 2002).*

[78] *The Unctad study, BITs in the mid-1990s (1998) supra is the only published study referring to numerous occurrences of this clause in modern investment treaties. The applicability of the clause was raised in the 2003 Nykomb v. Latvia award where the tribunal accepted its possible application, but felt the national treatment discipline provided sufficient legal basis for deciding the claim. Some information on the – restrictive – position there argued can be inferred from Richard Happ, Dispute Settlement under the Energy Charter Treaty, German Ybk Intl Law (published in 2003).*

with no at least explicit and "plain meaning" limitation to "investment contracts". Similarly, the obligations may have been entered with the (foreign) parent/investor, but also the domestic subsidiary controlled by the foreign investor. The strictness of the obligation is echoes by Art. 22 (1) – where states have "to ensure" compliance with state enterprises with such obligations. The ECT's formulation is arguably relevant for the interpretation of purely bilateral investment treaties, as the ECT, a multilateral investment treaty bringing together over 50 countries plus the EU, is an indicator for contemporary state practice; being the equivalent of probably over 2000 BITs between the member states, it has a measure of persuasive authority and serves as a precedential example of how a much more carefully negotiated and drafted multilateral treaty deals with the question at issue. It suggests that the "sanctity/umbrella" clause is indeed reflection of a currently predominant trend and points rather towards a wider than a more narrow scope for it.

International rules on treaty interpretation require that an "effet utile", i.e. a useful meaning, be assigned to treaty language. Treaty language, in particular in treaties which can be enforced by arbitration and even more so by privately initiated investor-state arbitration, is not only meant for public relations, but is, and is presumed, to have been meant by the Treaty negotiators, to mean something serious, in this case here a new obligation on states additional to the other justiciable obligations in such treaties (fair and equitable, national treatment, constant security, compensation for expropriation). Treaties, and in particularly those with privately initiated arbitration mechanism, can not be considered to contain "loose language" which the arbitrators in their wisdom can choose to ignore. In this particular case, arbitrators have to look both at the "plain meaning", but also at the explicitly identified purposes of the Treaty. In the Energy Charter Treaty which may serve here as the most elaborate and authoritative example of contemporary state practice, there is no doubt that such purposes include the promotion of private investment, the provision of a high quality of investment protection, the liberalisation of investment conditions and the encouragement of the rule of law protecting contractual commitment and other proprietary rights, in particular in situations and countries where such essential features of good-governance are not satisfactory. All modern investment treaty practice assumes that domestic protection of investor rights may not satisfactory; this is why the emphasis on external, enforceable disciplines. The inclusion and emphasis on the respect for contracts with foreign investors reflects the view that such respect is both unsatisfactory, but essential for encouragement of investment. It also

reflects the strategy of bilateral and multilateral investment treaties to formulate, re-state and develop customary international law on the duty of governments towards contracts with foreign investors in a way that solves existing controversies in an investor- and investment-friendly way – rather than in a way that would rather enhance the scope for unfettered state sovereignty. The emphasis in all modern investment treaties on investor-initiated arbitral enforcement suggests – as does preambular language – that the negotiators of such treaties and the designers of the models used in the more automatic negotiation of BITs placed particular emphasis on obligations that are effectively enforceable – rather than on good-will declarations of little legal significance as one finds in the less developed international investment instruments which do not include an investor-state arbitration facility[79].

It is before that general background of current investment treaty practice, that it is now time to recall the text of the pacta sunt servanda clause in the Swiss-Pakistan BIT underlying the SGS award:

The text of the clause – Art. 11 of the BIT - is as follows:

> *"Either contracting party shall constantly guarantee the observance of commitments it has entered into with respect to the investments of the investors of the other contracting party".*

The clause is, one should not forget, narrower than the comparable clause in Art. 10 (1) Energy Charter Treaty where explicit reference is made to "commitments" entered with an investor or an investment of an investor" (i.e. the domestic, but foreign-owned subsidiary). But it is the tradition version of the clause that has been around BITs since 1959; the tribunal would have benefited from appreciating the continuity of this provision in Pakistani BITs since the Pakistan-Germany BIT of 1959. The tribunal could have squeezed something in favour of its very restrictive approach out of this difference, but did not engage in a close examination of the wording. But the plain text – the

---

[79] *The ECT, Preamble, is quite clear about this focus on "placing commitments on a secure and binding international basis" and on "effective implementation". The nexus between the intention to provide specific protection duties on the level of international law and acceptance of international arbitration had already been identified in the Texaco/Calasiatic v. Libya award (supra). It is therefore not surprising that investment instruments which do not include international arbitration do also not include specific justiciable investment disciplines (such as the umbrella clause), but only adhortatory policy statements, for an overview of such instruments: Unctad International Investment Arrangements, CD Rom 2003.*

most significant element in interpretation according to the here controlling Vienna Convention on Treaties, ranked far above "context", "purpose" and "travaux" – seems quite explicit: There is an explicit obligation – "guarantee" – of a strict order; there is a reference to "commitments entered into" – and that should be 95% or more of a contractual nature and such commitments should relate to investments by foreign investors[80]. The fact that commitments may also include other non-contract forms – an administrative or interpretative assurance, an assurance provided in general legislation or other instruments of investment promotion – does not detract from the fact that of all forms of commitment a contract is surely the most formal and explicit. Since international law also requires an interpretation that makes treaty clauses effective – "effet utile" – and which promotes the purposes of the investment treaty (which is encouragement of foreign investments), the tribunal had to climb a very high hurdle in its quite persistent drive to interpret the "plain meaning", purpose, effect and applicability of this clause as far away as possible. It could have found a limitation in the "with respect to the investments" qualification; arguably, this qualification would have helped to manage the "floodgate" argument. Commercial contracts with the government which are not part and parcel of an investment (itself a now quite wide concept) package would not seem to fall under this clause. But contracts which are part of the contractual regime to set up and regulate an investment are clearly, explicitly and intentionally covered.

Let us look at the tribunal's arguments.

First, the evident horror of the tribunal to be dragged into assuming jurisdiction under the Treaty for every contract of a foreign entity with the government is evident from the tribunal's reference to counsel for claimant's position according to which a (any?) contract is "elevated" by an umbrella clause into a breach of treaty[81]. Possibly, the tribunal was faced here with an argument that went very far, suggested a

---

[80] This has been so far the general understanding of what is meant by "commitments" in umbrella clauses, see only Paasivirta, supra, 358/359 and Dolzer/Stevens supra. All view the meaning to such "commitments" to mean primarily investment-related contracts by the investor with the government.

[81] This argument is likely to have been based on Prosper Weil's much earlier analysis of the umbrella clause function. Paasivirta, supra, 359, also suggests that one way to interpret the clause is to view "any deviation from the terms of the contract" by the government as a breach of the Treaty. Note also Dolzer/Stevens and F.A. Mann in that sense – though without any in-depth examination of the question if breaches other than those conditioned by governmental interference are and should properly be covered by the pacta sunt servanda clause.

virtually unlimited scope and thus triggered (or helped the tribunal to argue) the "opening of the floodgates" fear. In fact, and had the tribunal and the discussion before it gone back to the customary international law position (i.e. existing prior to and outside the scope of the umbrella clause), it would have found that contracts of aliens with a government are protected under international law, but only if there are not "merely commercial", but have an element of governmental powers and prerogative;[82] possibly, following Francis Mann, it would also have required an element of "abuse" of government powers and the absence of a "legitimating reason". Finally, the plain text of the clause in the Pakistan-Swiss BIT suggests that only such contracts are covered which are related to the investment.

All four concepts could have allowed the tribunal to allay its fears over the "floodgates". Relying on international law before and outside the "umbrella clause", the test for the tribunal would have been: Is the SGS contract with Pakistan "merely commercial" or does it have a governmental character? Its earlier qualification would have provided an automatic answer: It is a contract dealing with matters iure imperii, a public concession or "contrat administratif", i.e. not a commercial contract outside the normal scope of international law, but a contract that involves the powers of government. If customary international law takes that position, the question then becomes if the "pacta sunt servanda" clauses in modern investment treaties merely "codify" existing (but somewhat debated) international law or if they carry out "progressive development", i.e. push the borders of contract protection by international law further than they were before. Even if there was a "progressive development" – for which strong arguments can be adduced from the fact that modern, pro-investment bilateral and multilateral treaties now use the umbrella clause extensively, the tribunal could have inferred a limitation out of the fact that investment treaties are intended to impose external disciplines on governments – but not on their normal, business-as-usual, dealings (should such dealings exist). The purpose and target of investment treaties is not normal, business-like conduct of government agencies acting as the "fisc", but rather the exercise of state powers. Such a limitation can be read into the clauses and preambles expressing the purpose and context of the treaty. The same limitation arises if the pacta sunt servanda clause is viewed as a formulation of contract protection

---

[82] *Stephen Schwebel, on whether the breach by a state of a contract with an alien is a breach of international law, in: Essays in Honour of Roberto Ago, Milano, Giuffre 1987 401; republished in Schwebel, 1994, op.cit. supra.*

under customary international law, but with an exclusion of "purely commercial contracts". The history of the emergence of the umbrella clause outlined earlier indicates that it was dominated by the desire to protect mainly concession contracts from interference and abrogation based on governmental powers. The few references that "any breach" would be covered has never been accompanied by a detailed analysis of the implications which, for the first time, has been identified by the SGS v Pakistan tribunal. Finally, WTO and ECJ jurisprudence on the "business judgement rule" and the "market investor principle" indicate the prevailing approach of international controls over state conduct relating to commercial dealings: That such controls are appropriate if the particular political and public-policy orientation in the exercise of governmental powers is present, but not if a state entity behaves under the same principles and incentives as a private business[83]. The tribunal could have – with the late Francis Mann – required an abusive or manipulative deployment of domestic law to escape from a now burdensome contract (as the tribunal did later when it speculated that the clause might hypothetically cover the undermining of an arbitral agreement). It could further have required the absence of a "legitimating purpose" for the exercise of government powers against the contract.

The tribunal then went on to suggest it is the first international tribunal dealing with the question. That is not correct – the Fedax v. Venezuela case applies – positively – the pacta sunt servanda clause in the Dutch-Venezuelan BIT to a promissory note contract, arguably of a nature that implicates sovereign powers much less than the much more "governmental" SGS contract with Pakistan. The Fedax tribunal did not give much thought to possible limitations in the umbrella clause, but the fact that it applied this clause without hesitation to a more commercial and less governmental contract than the SGS-Pakistan arrangement should have given to this tribunal at least cause to pause, reflect on the Fedax' tribunal's position and try to identify if the two situations were essentially distinct or not.

The tribunal pays lip service to the priority of ascertaining and applying the "plain meaning" – mandated by the Vienna Convention in Art. 31. But it does not carry out any literal interpretation which would require construing the terms "guarantee", "commitments" and "with respect to investments". In footnote 135 it rejects the claimant's reading "apparently extending to every contract or other commitment

---

[83] See most recently the EU Commission decision on the Ryan Air Case – airport of Charleroi case, Press Release IP/04/157 of 3 February 2004 on: www.europa.eu.int

that a contracting party has entered into" – in essence rejecting as "claimant's reading" what is the "plain text" of the BIT. In the tribunal's words, "guarantee the observance" of "some statutory, administrative or contractual commitment does not to our mind necessarily signal the creation and acceptance of a new international law". But international law – as Stephen Schwebel has demonstrated[84] – also indicated by the US Restatement (1987)[85] – does protect contracts with government of a governmental character against abrogation relying on specific government powers – including, naturally, those of entities forming part of the state by attribution. If this arbitration had first explored the pre-existing international law with respect to contracts, it might have come to the conclusion that the issue is either between the "umbrella" clause simply re-stating the majority international law position or "progressively developing" this position with a focus on the exercise of state powers against contracts. But the tribunal's fears were – based on a not exhaustive examination of the issue – that the "textuality" "appears susceptible of almost indefinite expansion" (para 166). In other words: The tribunal recognises that the plain meaning means that contracts with government are to be protected but shrinks before the horror vacui of floodgates being widely opened. With the reference in para 167 to legal consequences being "far-reaching", "sweeping" and unqualified", the tribunal shifts the burden of argument that the text intends what it plainly means back onto the claimant. It requires proof that the parties intended what they said in plain meaning. It seems a reversion of the normal way the burden of proof (or here rather legal argument) is regulated to require a party to prove persuasively that what a treaty clearly says is what it means. The normal rule is the opposite: If the plain meaning is clear, the party disagreeing with the plain meaning has the burden to persuade the tribunal that the proper meaning is different from a superficially apparent meaning.

The proof required by the tribunal in the form required – evidence of a specific intention of the Swiss and Pakistani negotiators that the umbrella clause means what it says – is unlikely to be available. BIT negotiators – different from the much more complex and usually better documented processes of negotiating multilateral treaties –

---

[84] *Supra, 1987;*

[85] *Section 712 (1986) provides:*

> *"A state is responsible under international law for injury resulting from a repudiation or breach by the state of a contract with a national of another state where the repudiation or breach is discriminatory or motivated by other non-commercial considerations and compensatory damages are not paid".*

tend to use existing models in a "boilerplate" fashion – and mainly those considered "advanced" and "modern". Advanced/ modern bilateral investment treaties (mainly US/UK) and in particular the multilateral Energy Charter Treaty provide such models. The proof that the Pakistan-Swiss sanctity/umbrella clause is nothing rare or exceptional, but just one occurrence of prevailing modern practice could have been easily substantiated by a rapid survey of recent BITs, of Art. 10 (1) of the ECT and of the 1998 study by Unctad on BITs[86]. If the tribunal had been worried that it was facing an exceptional formulation, perhaps made by mistake by ignorant, thoughtless or cunning Swiss negotiators ramming an obligation with massive implications down the throat of naïve Pakistani civil servants, it could have corrected such impression by looking at BITs of the same generation, the benchmark Energy Charter Treaty or even the 1959 Germany-Pakistan BIT. It is normal, and indeed prevailing practice, that relatively standardised treaties as any other standardised legal documents, use "boiler-plate" language. Such language is usually adopted from pre-existing and respected models. One can not refuse to give effect to such language by requiring, in each instance and for each legal instrument using such language adopted from other models, evidence that the parties have explicitly discussed the respective clause, thought about it deeply, considered the consequences, obtained legal opinions and clearly and in all of its consequences understood perfectly what they were agreeing to. Such a requirement may fit modern consumer protection law directed at standard "fine print" clauses and protecting widows, orphans, housewives and the mentally retarded from signing up to exorbitant deals at the door of their house, but it has no place in the transactions between "adults" such as two – and here on one side – very large countries.

The umbrella clause in the Swiss-Pakistani BIT is unlikely to have led to distinct discussions – it was rather the application of standard language copied from numerous – in fact most – modern investment treaties. The language of the clause is virtually identical with the 1959 Germany-Pakistan BIT's "pacta sunt servanda" clause. The background of this clause is that the – usually capital-exporting – proponents of investment treaties wanted to reduce legal arguments based on the "New International Economic Order" positions, that is the exclusion of international law and accountability for acts – here in particular breach and revocation of contracts – by – mainly third-world –

---

[86] *Also by the discussion of the umbrella clause in the standard work on BITs by Dolzer & Stevens, supra. Unctad, supra.*

governments[87]. The pacta sunt servanda clause was one of several formulated legal concepts[88] to reject the NIEO-related concepts that governments can breach contracts at will – it affirms, as does all modern BIT practice, the position that governments have an international duty not to rely on governmental powers to breach contracts concluded with foreign investors[89]. The statement made in the award that a violation of a contract entered into by a state with an investor of another state is not, by itself, a violation of international law is therefore not fully correct. A purely contractual-commercial breach of a purely commercial contract with the state acting as "fisc" is unlikely to be a violation of international law, but the moment a contract is part of an overall investment arrangement and implicates the involvement of governmental powers in the conduct and breach of the agreement, it is likely to be seen a violation of international law, except if there particular legitimating circumstances. For the more restrictive writers, the additional requirement of "abuse" may be added; an excuse may therefore exist, if the state can prove that governmental conduct undermining the contract (rather than an explicit "breach") reflects laws of general application which legitimately, and without discriminatory elements and specifically targeting the investor, regulate economic affairs in a general way. The tribunal places itself here into the shoes and minds of the most radical NIEO-advocates of the 1970s. Those indeed advocated a position of absolute sovereignty where the "state can do no wrong" and where contracts with foreign investors were not a matter of international law[90], but only of domestic law and therefore at the mercy of the host state. The tribunal aligns itself with the Che-Guevara approach to international law on the protection of foreign investment.

---

[87] *Denza/Brooks and Scott Gudgeon, op. cit. supra*

[88] The other ones: stabilisation clauses; international arbitration and finally treaty, not contract-based, direct investor-state arbitration relying on a number of specific treaty disciplines (compensation for expropriation; fair and equitable treatment; national treatment; full and constant security and protection; repatriation of revenues)

[89] *The mostly cited (and from a NIEO perspective heavily criticised, case is Texaco/Calasiatic v. Libya 53 ILR (1979)389). But see also the last unanimous UN resolution on Permanent Sovereignty over Natural Resources of 1962 (1803 –XVII UNGA): ""Foreign investment agreements freely entered into by .. sovereign states shall be observed in good faith". On its evolution: Schwebel, The Story of the UN declaration on permanent sovereignty over natural resources, in: Schwebel,. 1994, 401*

[90] Note the references in the narrative by Schwebel of the origin of the 1962 UN permanent sovereignty resolution, and in particular to the positions then taken by the Soviet Union.

The tribunal should rather than looking for specific "travaux" evidence – of third rank after plain meaning and context and purpose and applicable only in case a plain meaning result leads to "absurd" results[91] – have looked at relevant modern state practice with BITs. It would have found out that a large number – perhaps a majority – of modern BITs include "umbrella clauses". Some – e.g. Art. 10 (1) ECT – are clearer, less limited and have an explicitly wider scope than the formulation in the Swiss-Pakistan BIT. If there is such a frequent contemporary practice, then the tribunal's concern over implementing an untested innovation in international law with unforeseen consequences would no longer be justified. If there is such a widespread practice, would it not have been proper for the tribunal to rather refer to and respect the intention of the hundreds of drafters and negotiators of such treaties than letting its own subjective feeling prevail, against current state practice, with the sentiment that such "textuality" goes simply too far? If the tribunal had followed properly – and literally - the Vienna Convention, it would have tested the plain meaning not against a not available (and certainly not negative) evidence of the Swiss and Pakistani drafters; it essentially required positive evidence that the drafters who had copied this clause from the modern practice meant what they said. The right approach would be to ask: Does the plain meaning conform, or contradict, the formal objectives of this treaty – and all other comparable treaties – to promote investment? The question then is if it is respect for contracts by a government which promotes investment or is it the ability of a government to break a contract at will, unconstrained by any external and international obligations as advocated in NIEO-times[92]? Had the tribunal asked this question – proper under the interpretation rule of the Vienna Convention referring after the "plain meaning" to the "purpose" – it is hard to see how it could have come to the conclusion that the "textuality" should be disregarded and this clause be without any serious effect. A lack of legal culture, of respect for property and contractual commitment is the distinctive feature of countries with a high political risk rating and inability to attract investment – both domestic and foreign. Underdevelopment is strongly correlated with an absence of respect for contractual commitments. Changing this by external disciplines is the very function of investment treaties – an instrument of good governance not only to protect foreign investors,

---

[91] *It is ever useful to look carefully at an authoritative legal text – here the Vienna Convention's guideline for interpreting treaties in Art. 31. The SGS-Pakistan tribunal seems to have treated the Vienna Convention in a similar cavalier fashion as it treated the plain meaning of the Pakistan-Swiss BIT.*

[92] *Most relevant here UNGA Resolutions 3201 and 3202 of 1974 on the "New International Economic Order".*

but to create a "culture of commitment" as a key component of good governance[93].

The tribunal, however, wishes to leave some effect in the clause, rightly concerned that its approach in effect replaces a deal that was negotiated between two governments on the basis of extensive bilateral and multilateral treaty practice, by the sentiment of a three-people tribunal that what the two parties negotiated goes too far. The effect that it comes up with is that the clause could mean an:

> *"implied affirmative commitment to enact implementing rules to give effect to a contractual or statutory undertaking in favour of investors".*

It is most unclear what such an "implied affirmative commitment" could mean. While a duty to comply with governmental contracts concluded with foreign investors is quite clear, such an implied commitment to enact implementing rules is utterly unclear. Would an investor then be able to sue a government because its national law – contract law, company law, procurement law, public law, tax law – does not protect contractual commitments sufficiently? The solution the tribunal finds looks similar to what an EU directive is about: To provide a framework obligation for enacting national implementing legislation, sometimes on the Francovich-principle with a right of individuals to sue governments for damages for unsatisfactory implementation of a legal reform directive. But such a complex scheme is not envisaged by umbrella/sanctity clauses, nor in the Swiss-Pakistan BIT, nor in the ECT nor in the other hundreds of BITs with an umbrella clause. What the tribunal suggests has the potential for a far wider intrusion into domestic law. If treaties wish to impose a far-reaching legislative reform obligation on countries, in the style of a EU directive unfamiliar outside the EU context, then treaties should spell this out explicitly – as some, e.g. the OECD anti-bribery convention – explicitly do. Treaty practice requiring national implementing legislation tends to be very explicit. Requiring an intrusion into national regulatory sovereignty when nothing is explicitly stipulated in a Treaty conflicts with the very rules on restrictive interpretation the tribunal earlier supposedly wished to adopt. The unequivocal meaning of the term "guarantee" is the opposite of the result reached by the

---

[93] *T Waelde/T Weiler, investment arbitration under the energy charter Traty in the light of new nafta precedents, 159 in: G. Kaufmann-Koehler/B. Stucki, Investment Treaties and Arbitration, ASA Swiss Arbitration Association, Special Series No. 19, Zurich 2002; also:T. Wälde,* ***Investment Arbitration as a Discipline of Good Governance, in: T. Weiler (Ed) NAFTA, Investment Law and Arbitration, Transnational Publishers, 2004***

tribunal: "Guarantee", in plain English, means a strict obligation, with no escape – not a soft-law, best-effort obligation to establish a rule of law for foreign investors in domestic law which is the result reached by the SGS tribunal.

The only direct application the tribunal is ready to hypothetically accept is if a government would undermine a contractual arbitration clause – presumably by anti-arbitration injunction such as issued by the Supreme Court of Pakistan against BIT arbitration. There is nothing wrong in using the pacta sunt servanda clause to protect, on the level of the Treaty and international law, an arbitration commitment[94]. But why should the "pacta sunt servanda" clause only protect an arbitration contract, usually part of the investment contractual package, but not the main body of an investor-state contractual arrangement? The tribunal here gets entangled in its own contradictions: How can it on one hand negate the "guarantee" for contracts by the umbrella/pacta sunt servanda clause and interpret it as a nebulous soft-law obligation to ensure the domestic system upholds contractual commitments, while on the other hand upholding the strict and "hard-law" "guarantee" effect when it concerns the arbitration component only of a contract with government? Existing international law is sufficient to deal with attempts by government to frustrate a prior arbitration agreement it has entered[95]. There is little need – but also no objection – for relying on the "umbrella clause" to solve a problem that international law has already settled. Possibly, the tribunal has here found an innovative solution reinforcing prevailing international law rules against governments trying to escape from arbitration commitments. But the construction of the tribunal excluding any other commitment effect from the pacta sunt servanda clause is contrary to the plain meaning of the clause, both in the Swiss-Pakistan BIT and current practice: At no place does the text of the clause envisage or refer to a distinction whereby some commitments – e.g. the arbitration agreement – are "guaranteed", while for other commitments, to be split from the arbitration agreement, the clause does not apply and is replaced by a soft-law, best-efforts duty for legislative reform.

Lastly, the tribunal relies on the location of the "umbrella clause" in the Pakistan-Swiss BIT. This locational argument would only be specific to umbrella clauses located at the end of a BIT, and not, as

---

[94] For a survey on this issue: Schwebel, International Arbitration: Three Salient Problems,l Cambridge Grotius 1987, 61-125.

[95] *S. Schwebel, International Arbitration: Three Salient Problems, Cambridge, Grotius 1987*

probably many or even most, in the "obligations" part of the treaties. The pacta sunt servanda clause in the Pakistan-Swiss BIT is preceded first by several substantive obligations, then a subrogation and two dispute settlement articles. Art. 11 "Observance of Commitments" is placed right before Art. 12 – "Final Provisions". The tribunal infers from this locational sequence a ranking, with the purpose to downgrade the rank of the umbrella clause and thus distinguish it from the "substantive obligations". The tribunal argues that the pacta sunt servanda provision is not a "first order" substantive investor-treatment obligation, but rather something else – and much weaker. But that is to read too much in the enumeration order of substantive obligations in BITs. Treaty drafters – regrettably perhaps – do not always write treaties in the form of systematic academic treatises. Clauses tend to be copied from various models and then put together. The positioning after the dispute settlement provisions could have been argued to suggest that the "pacta sunt servanda" provisions was seen by the negotiators as not a secondary, but a priority provision to be highlighted. The fact that this pacta sunt servanda/umbrella clause is not just part of a clause containing a number of obligations, but merits its own article at the conclusion of the treaty, entitled "Observance of commitments", suggests that the parties wanted to highlight the importance of "pacta sunt servanda" as an overarching obligation. In the MAI negotiations, for example, several governments proposed that the pacta sunt servanda clause be placed into a separate provision called "Respect Clause". Both Swiss international commercial culture, but also the Sharia law applicable in the Islamic Republic of Pakistan, would be very supportive of highlighting a statement that "A Commitment is a Commitment"[96]. Had – to use the often relied upon approach of the tribunal – the drafters wished to give to this clause a secondary role, they could have (as is done for some obligations for example in other treaties, e.g. Art. 6 or 19 of the Energy Charter Treaty) expressly excluded the umbrella clause from the scope of the dispute settlement mechanism or they could have limited the application of the umbrella clause (as, again, done in Art. 26 (3) of the ECT). But they did not do this – the Swiss-Pakistani BIT includes clearly the umbrella clause in the obligations covered by arbitration under the Treaty. While interpretation transcending the "plain meaning" – relying on purpose, context and common elements in Swiss and Pakistani legal culture – can reinforce and explain the significance given in the Pakistan-Swiss BIT to "Observance of

---

[96] *Under Islamic law (Sharia) every lawful contract must be observed. This principle is supported by the following verse from the Holy Quran. "Oh you who believe, observe covenants". (Almaeda Sura, Chapter 5, verse 1.)*

Commitments", it is not really necessary: The "plain meaning" approach provides a solution that is not difficult to ascertain: Disputes between a Swiss investor and Pakistan can be submitted by the investor to Treaty-based arbitration. The law applicable to the dispute, according to the relevant Art. 42 (1) of the ICSID convention is primarily the Treaty. The Treaty's rules contain in Art. 11 the "sanctity/umbrella clause". The Art. 9 (or 10) arbitration mechanisms of the Treaty do not (as in other treaties, e.g. Art. 26 (3) ECT) limit the applicable rules only to Art. 1-8, but not to 11 of the Treaty[97].

The tribunal also feels that if it would give a real meaning to the "pacta sunt servanda" clause, the other obligations – expropriation, fair and equitable, discrimination etc – would be superfluous. But this again is not correct: A "pacta sunt servanda" clause in essence makes the investor's contractual arrangements with the host state justiciable by Treaty arbitration, thus protecting the investor's recourse to international justice from the jurisdiction of domestic courts which are, and mostly rightly, suspected to be in the pay and under the control of the host state. It does not make other obligations redundant: An expropriation[98] or discrimination can occur without that a specific host state contract is breached;[99] a host state can breach the "fair and equitable treatment" obligation, e.g. by administrative harassment by government agencies or through breach of a non-contractual, investment-backed legitimate expectation[100], even if there is no contract with the host state or if the contract is not with the agency that carries out administrative harassment. The tribunal substitutes here, again, its own judgement of how investment treaties should be drafted for the judgement of all the treaty drafters who have intentionally and explicitly added the "sanctity of contract" clause in modern bilateral and multilateral treaty practice. These drafters must have thought the addition of this clause would bring protection that was additional to the protection in the already available investment disciplines – either by clarifying controverted customary international law or by extending customary international law ("progressive codification"). Otherwise one can not explain why modern, in particular

---

[97] *This result can be confirmed by another provision envisaged in the award: Art. 7 – "Most favourable provisions" – allows the import of more favourable provisions agreed by either of the two parties with an investor of the other party. If a more favourable provision can be imported from another investment contract, then one can not find a reason to exclude, without specific language to this effect, the favourable Art. 11 of the Pakistan-Swiss BIT from having full effect.*

[98] *E.g. CME v. Czech Republic; Metalclad v. Mexico*
[99] *Myers v. Canada; Feldman Karpa v. Mexico*
[100] *Pope-Talbot v. Canada; Tecmed v. Mexico*

post-1990 practice, witnesses an explosion of the occurrence of the pacta sunt servanda clause in investment treaties. The most likely underlying intention is to contradict by treaty practice the NIEO-assertions about absolute host state powers over contracts signed with foreign investors, but perhaps also to take into account the temptations and risks inherent in the dual role of the state as both contract party and regulator of such contracts.

Had the tribunal examined pre-existing international law on breach of government contracts, including the NIEO controversy between Third-World and Western countries' concepts of contract protection more closely, had it paid more than lip-service to the plain meaning approach mandated by the Vienna Convention, had it related the respect for contractual commitment with the investment promotion purposes of this – like all other – investment treaties and had it paid attention to the now prevailing state practice of including increasingly explicit "pacta sunt servanda" clauses, it would not have dismissed the explicit text, with no evidence at all of a contrary meaning available from the travaux of this as of all other comparable treaties, with so much nonchalance. A tribunal's task, in my eyes, is to read a text faithfully and only correct it if the result is manifestly absurd (so the Vienna convention on treaties) rather than supplant a clear text expressing a clear intention of the Treaty drafters with the tribunal's judgement of what goes too far. The Vienna Convention allows a correction of plain text and intention when a result is "manifestly absurd". But it is a tall order to allege that the drafters of hundreds of umbrella clauses in modern investment treaties all have produced a "manifestly absurd" result which it is the task of this particular tribunal to correct.

There is – as all other relevant cases and the customary international law demonstrate – no risk of "opening the floodgates" as both international law and all relevant recent precedent cases require that contract-related conduct displays a significant element of "governmental nature" before they apply a treaty's protection – with or without umbrella clause – to contracts signed. Possibly and arguably, the claimant must also allege that government powers be exercised in an abusive way. Recent cases on the attribution of state enterprise contracting responsibility to the state indicate that both from a structural and functional perspective such contracting conduct must display a governmental dimension[101]. The contract must also

---

[101] *Most detailed and most recently: Salini v. Morocco; Maffezini v Spain (jurisdictional and award on the merits); earlier already Tradex v. Albania; FK.H.*

have a relevant function in the contractual regime set up for an "investment" as defined by the particular treaty. Finally, a contract is not protected against legitimate, general and non-targeted government regulation which happens to affect the context of a contract. This contract was – as the tribunal recognises – an eminently iure imperii – governmental – contract. Its conclusion and its breach was not a matter of private commercial judgement, but involved governmental power and politics at the highest level. It is the very type of contract for which investment protection treaties have been designed. With the umbrella clause, investment protection treaties have become "contract protection treaties" – and not only for the sake of the foreign investor trusting in the government's willingness to honour a formal commitment made, but also or the sake of the host state's ability to develop good governance in a way so that capital can be attracted and economic development be encouraged, with a further positive repercussion on how governments treat their own, domestic investors.

The tribunal, in its jurisdictional decision, was in my mind wrong to treat the umbrella clause in such a dismissive way as it did. This award has no persuasive effect, but rather sends a warning about how not to go about application of the pacta sunt servanda clause. The tribunal was given by the BIT jurisdiction to decide on contractual commitments of a governmental nature entered into with an investor. If it does not accept such jurisdiction, it commits the same error as the original Vivendi tribunal award that was ultimately, and rightly, annulled. This view has so far been shared by all other commentators, including the SGS v Philippines tribunal[102].

But while the almost complete rejection of the applicability of the pacta sunt servanda clause in this award is not tenable, the award and its arguments serve a useful purpose: The arbitrators have identified – as the first tribunal ever – the difficulties of applying this provision not as it was originally intended – as a control on governmental interference in investment-related contracts, related to and complementing the expropriation disciplines, but of lifting any contract issue, even matters involving only matters of contract law and mutual performance, to the level of international law and BIT-based tribunals. These issues had not been examined and thought through fully by the few

---

Boeckstiegel, Der Staat als Vertragspartner auslaendischer Privatunternehmen, Athenaeum, 1971 p. 58 to 75

[102] C Schreuer, Travelling the BIT Route, J World Investment 2004; SGS v. Philipines award, supra; S. Alexandrov, Introductory note in ILM for SGS v Pakistan award, supra.

commentators who thought the clause applied also to "mere contract breaches"[103], but the SGS v Philippines tribunal did recognise them. If the pacta sunt servanda clause applied to "any contract" of foreigners with any governmental entity or state enterprises, then BIT-tribunals would indeed become a court of first instance or an appeal authority for any of the innumerable contract disputes likely to arise. That is not a practical solution; it also does not fit into the historical context and the original intention of the pacta sunt servanda clause. It also is not compatible with the general approach of investment treaties: these treaties impose disciplines on governmental conduct, but not on any commercial involvement of state entities when these are characterised by a commercial and contract law nature, and do not involve specifically and characteristically the use of or reliance on governmental powers. The umbrella clause and investment treaties target an abuse of the state when situated in its dual role as both contract party and regulator. When the dual role is absent, and state entities participate in the market as normal market participants, there is no role for application of investment law disciplines – an approach that is reached by the much more intrusive disciplines under, for example, the EU Treaty or the WTO. The merit of the tribunal was to identify these issues much more clearly that most commentators had done before; [104] the critique presented here rather focuses on the solution: The tribunal should have restricted the pacta sunt servanda clause to situations it was made for, rather using a hypothetical situation for which the clause was not made to reject its applicability in toto.

The SGS v Philippines Award

The SGS v. Philippines tribunal[105] had to deal with a claim for payment of about 200 M $ on a contract for provision of customs inspection services. The pacta sunt servanda clause said:

---

[103] Supra: F. A. Mann; Dolzer/Stevens op.cit. supra

[104] But note my treatment of Art. 10 (1) ECT where I distinguish between "governmental" and "commercial conduct" and suggest that the clause would not apply to contract disputes over the purchase of fuel oil by a French village" – T. Wälde, International Investment under the 1994 Energy Charter Treaty, in: 29 JWT 5-72
(1995)

[105] 42 ILM 1285 (2003); chairman: A.Al-Kosheri, J. Crawford and A. Crivellaro

> *"Each contracting party shall observe any obligations it has assumed with regard to specific investments in its territory by investors of the other contracting party."*

The tribunal accepted that the clause were applicable to these obligations arising out of the SGS contract. It rejected the argument that the clause only applied to obligations out of other treaties; the wording of the particular clause at issue could cover such a more restrictive interpretation – other formulations (e.g. Art. 10 (1) ECT is clearer and covers explicitly obligations entered into "with an investor" or "an investment of an investor" (i.e. the domestic subsidiary of a foreign investor). This interpretation is correct. The survey of the historical evolution of the pacta sunt servanda clause indicates that the clause was originally formulated and then entered into investment instruments to cover specifically investment-related and very much concession-type of agreements with private foreign investors, i.e. it intended to provide international law protection to state contracts which host states then argued (and probably continue to argue now) would exclusively fall under domestic law. The tribunal was faced with the SGS v Pakistan award rendered several months earlier. The tribunal disagreed with this award's quite different view of the pacta sunt servanda clause. The SGS – Philippines tribunal suggested that the SGS – Pakistan tribunal failed to give proper effect to the intentions of the clause, in particular (para 126):

> *"It does not convert non-binding domestic blandishments into binding international obligations. It does not convert questions of contract law into questions of treaty law. In particular it does not change the proper law of the CISS Agreement from the law of the Philippines to international law. Article X(2) addresses not the scope of the commitments entered into with regard to specific investments but the performance of these obligations, <u>once they are ascertained</u>.*[61] *It is a conceivable function of a provision such as Article X(2) of the Swiss-Philippines BIT to provide assurances to foreign investors with regard to the performance of obligations assumed by the host State under its own law with regard to specific investments—in effect, to help secure the rule of law in relation to investment protection. In the Tribunal's view, this is the* proper interpretation of Article X (2).

While the tribunal seems at first sight to give therefore considerable, and much wider scope, to the clause than the SGS/Pakistan tribunal, a closer inspection reveals that the differences are in fact not that

substantial: The second tribunal requires ("absent other factors" – para 128) in effect that if there is another tribunal closer to the contract – and that will be either a domestic court or a contractual arbitral tribunal, then this tribunal has the key jurisdiction, with the BIT-based tribunal merely having a jurisdiction that (the award is not clear on this) may include merely support for the first-level court-tribunal's judgement and, possibly, a review function, perhaps under the "denial of justice" concept[106] In the SGS / Philippines case, the claim for payment was not as yet either determined and accepted – though the disputed amounts seem to have related only to about 10% of the total claim. The tribunal therefore (by majority decision with a dissent by Professor Crivellaro) decided to suspend the proceedings indefinitely. In essence it told the claimant to get a judgement from the domestic court and then come back to it if the claimant considered such judgement was not satisfactory or not complied with by the government.

The vigorous criticism of the latter tribunal of the first tribunal's award should, therefore, not hide the fact that in substance the decisions were fairly similar: Both tribunals refused to decide on the contract claim[107], and largely because of the fear of the floodgates' opening. That fear was expressed more sincerely in the first award, and was clothed in much more technical considerations in the second award. The SGS / Philippines tribunal could, on the facts reported in the award, probably have made an award against the Philippines to the extent the claim was (up to about 90%) not seriously contested and possibly even accepted. While in its reasoning strongly advocating "adequate certainty" (para 126), it left open under what conditions it would re-open the proceedings and what standards it was ready to apply. For example, it might have given an adequate waiting period (some BITs use a 18-months exhaustion of domestic remedies waiting period[108] before allowing recourse to BIT-based arbitration); it might have defined at which level of Philippine court proceedings it would be prepared to intervene again and it should have defined its standards of control over such domestic judgements, most likely to be related to traditional "denial of justice" principles as discussed in the recent Azinian v. Mexico and Loewen v. US awards under the NAFTA. The

---

[106] Schwebel, 1987, 61-125; see recently Andrea Bjoerklund, in: Weiler, 2004, op. cit. supra (dealing inter alia with the Loewen case)

[107] Technically speaking, the Philippines tribunal accepted jurisdiction and saw the claim as not (yet) admissible, para 154. The distinction between jurisdiction and admissibility is not a very clear one – and particularly not in this case.

[108] E.g. Art. 10 3 (a) of the Germany-Argentina BIT (available in the 2004 UNCTAD CD Rom on BITs)

immediate recourse to Treaty-based arbitration in modern BITs has explicitly done away with the traditional principle of "exhaustion of domestic remedies". But the second SGS tribunal in effect re-introduces this limitative principle at least for the situation where the "pacta sunt servanda" clause under a Treaty-based tribunal's jurisdiction meets a contract dispute under domestic law. The SGS / Philippines tribunal is therefore closer to the original, later annulled Vivendi award than the position of the ICSID annulment committee in this case[109]. The Philippines tribunal tries to distinguish its case from the annulled Vivendi case (para. 158), but in this case there was no "pacta sunt servanda" clause nor was the substance of the claim as much uncontested as it was in the Philippines case.

How did the tribunal justify its decision which is explicitly distanced from the earlier SGS/Pakistan award, but in substance much closer than it seems and than the tribunal wishes to acknowledge? While there are other considerations (paras 139 et seq), the tribunal essentially relies on the fact that the SGS-Philippines contract provided for the jurisdiction of the Philippine courts (para 155) which, it seems, was a "freely negotiated" jurisdiction agreement. The tribunal said in essence: You can not come to us complaining of a breach in the contract with the government under the "pacta sunt servanda" clause if you yourself are unwilling to stick to the jurisdiction clause in favour of domestic courts in that very contract. This appears, at first sight, eminently logical. Different from other cases where jurisdiction of domestic courts had not been an obstacle to a Treaty-based tribunal from assuming jurisdiction, [110] the tribunal here had the claimant relying on the umbrella clause protecting a contract. So it could in effect conclude that he who claims on a contract umbrella clause must also respect the contract's jurisdiction clause. The more "special" contract – itself guaranteed by the Treaty – therefore overrides the more general BIT-protection if the contract itself provides its own jurisdiction.

These considerations – much more technical and sophisticated than the much more direct and openly worried SGS-Pakistan tribunal – appear convincing at first sight. But they are not convincing in the end and with respect to the result. First, the tribunal after having advocated certainty leaves everybody in the confused: The tribunal continues to operate, but is suspended. It is not clear when and how

---

[109] 41 International Legal Materials 1135-1163 (2002)

[110] Vivendi annulment; CMS v Argentina; Azurix v. Argentina; Wena v. Egypt; LANCO v. Argentina – www.worldbank.org/icsid

the tribunal's proceedings can be re-initiated and what the tribunal will do if it is requested to re-start its proceeding. Second, the tribunal has converted, in fact perverted, the "pacta sunt servanda" clause from a clause that is clearly and incontrovertibly meant to add protection to investors with contract disputes to a clause that forces them to face domestic courts; this clause, however, as all evidence indicates, was meant to be a principal instrument to "internationalise" investment disputes involving state contracts and to bring them before an international tribunal rather than domestic courts not accepted then and now as independent from the government of which it forms part. As the tribunal distinguishes itself from the Argentine non-umbrella clause BIT awards (which all assume full jurisdiction, with no reservation about admissibility), the umbrella clause becomes a handicap rather than an asset for the investor – the contrary of what was intended by the "pacta sunt servanda" clause creators. Furthermore, in a vein quite similar to the original, later annulled Vivendi-award, the tribunal discusses the question if a contractual jurisdiction clause can "waive" the BIT-protection. Correctly, and quite similar to the original Vivendi decision, the tribunal rejects theoretically this line of argument, but the effect of its decision is that an investor can be made to accept domestic jurisdiction clauses and thus, in effect, give up Treaty protection apart from a last-resort "denial of justice" claim. Denial of justice claims are difficult to prove as tribunals inevitably will be pushed towards collegial and sovereignty-based deference with respect to domestic court decisions; they will apply deference, accept broad margins of appreciation and wide discretion to interpret domestic laws – much as the Loewen v. US tribunal. In effect, the "exhaustion of domestic remedies" clause is thus re-introduced after (as the tribunal here fully recognises) having been explicitly discarded by modern BITs. It is therefore hard not to agree with the lucid and practical dissent by Antonio Crivellaro. The SGS v. Philippines tribunal may have been much more elegant from the perspective of legal theory than the much more frank SGS v Pakistan tribunal, but in effect and result it reaches the same result: The pacta sunt servanda clause diminishes, rather than reinforce, the position of the investor; the policy and original intention of this clause was to internationalise an investment-related dispute in terms of applicable rules and competent jurisdiction. The SGS v Philippines tribunal does the opposite. It uses throughout the right maps in a way that appears proper, but it goes off into the wrong direction.

But how could the tribunal have solved the difficult issue that was identified well by the SGS – Pakistan tribunal? The proper approach, we suggest, is to go back to the original intention of the pacta sunt

servanda clause and to adapt it to the contemporary BIT context: The original intention was to internationalise, as an adjunct of the expropriation provision, the protection of investment agreements with governments against an abuse of the powers of government to deny the validity of the contract to which the government entity is a contract party. One needs therefore to characterise the contractual relationship, and in particular the incriminated conduct of the involved government entity leading to the alleged, as "governmental" rather than "merely commercial". A Treaty and a Treaty-based tribunal should not sit over purely commercial contract disputes. It is when government powers and prerogatives come into play, and when the question of their abusive exercise is raised, that the Treaty's purpose and function needs to be activated. This can go with a system of double presumptions: A rebuttable resumption that a contract with a government agency relating to an "investment" has a governmental character, and a second-tier rebuttable presumption that a dispute involving a government agency seeking to escape from the obligations of a contract is not "merely commercial", but also and in a significant extent "governmental".

In the SGS v Philippines case that test is likely to have led to a qualification of the contractual arrangements as at least partly governmental. The issue of the alleged breach is more difficult to decide on the basis of the facts available. If the government had plausibly conceded most of the claim, but refused to comply, then it is likely to have relied on its prerogatives of government and its expectations of control or influence over domestic courts to avoid compliance. That would seem to be an abuse of governmental powers to avoid and in effect destroy the value of an investment-backed contract – precisely what the fathers of the "pacta sunt servanda" clause had in mind. On the other hand, if there were substantial disputes of fact and applicable law, with the "gravity" of the dispute rather turning around application and interpretation of domestic contract law, then the solution is to let the domestic court decide first, and reserve the tribunal's jurisdiction for a subsequent phase of "denial of justice". As all complex disputes, an element of appreciation of the facts in light of the relevant Treaty disciplines and a balancing of conflicting elements is required. Not everybody would agree if a certain measure is "merely" commercial or also "governmental", in particularly if the government camouflages its intention to use its powers to avoid complying with a contract under apparently professional and technically correct procedures – "velvet" expropriation of contracts. But the criteria we suggest at least provide a conceptual framework to both avoid the much feared opening of the

floodgates, the functioning of Treaty tribunals as appeal bodies for relatively petty "normal" contract disputes, but also to give proper weight and an effective function (rather than a pure rhetorical accommodation) to the original intention of the pacta sunt servanda clause to – to translate literally – that contracts of foreign investors with governments are properly observed. They also serve the good-governance function of treaties: To provide an externally anchored discipline encouraging government entities (including local courts) not to allow an abuse of government powers in situations where the counter-party to the government is a foreign investor.

Conclusion

After 55 years of lying dormant, the pacta sunt servanda/umbrella clause in investment treaties has suddenly sprung vigorously to life. The two SGS / Pakistan, SGS/Philippines awards of 2003 have been the first tribunals that have not only been faced with the issue, [111] but have also struggled with it. These struggles have not as yet produced a satisfactory result, but have identified some of the issues to be dealt. The SGS v. Pakistan tribunal has properly identified the massive expansion of cases that could come to BIT arbitration – which was not designed for purely commercial contract disputes, the SGS v Philippines tribunals recognised the link between the substantive rule and the recourse to an appropriate jurisdiction. The final and substantive result of both awards is not satisfactory: The SGS v Pakistan tribunal narrowed unconscionably the scope of the substantive obligation, while the SGS v Philippines award re-introduced a principle of exhaustion of domestic remedies for the contracts of foreign investors with the government if such contracts, as frequently, include a domestic jurisdiction clause. It thereby thwarted the original intention of the drafters of the clause which was to internationalise by substantive and jurisdictional rules disputes about investment contracts threatened by abuse of governmental powers when the government, in its dual role as contract party on one hand and regulator on the other, abused its governmental power to escape from its contractual obligations.

[111] Other tribunals were faced with the clause as well: Fedax v. Venezuela accepted and applied the clause, but without in-depth review, the first ECT-based award faced, but eschewed the issue.

But the benefit we have now is not only an extensive discussion of the implications of the pacta sunt servanda clause in real-life factual situations, but also a much better idea of how and why the pacta sunt servanda clause came into being. Such insight was, it seems, not available to both of the tribunals and the litigating parties. With the now available benefit of quite reliable indicators of the "original intention" of the drafters, it appears that the pacta sunt servanda clause was introduced in the 1950s – and spread from 1959 to many if not most contemporary bilateral and multilateral treaties (excepting Chapter XI of the NAFTA) – in order to internationalise the protection of investment (then mainly concession) contracts with governments against abusive governmental abrogation and interference by both substantive rules (directed against such intervention) and access to non-national international jurisdiction (mainly ICJ and arbitration). This strategy was seen as a special case, complement and adjunct to protection – again by substantive and jurisdictional internationalisation – of property against expropriation without full compensation. The clause was much formulated to counter legal arguments advocated by host states, very much in the Anglo-Iranian case, that such contracts were exclusively subject to domestic law and to jurisdiction by domestic courts.

The context has changed since in several significant aspects: First, the clause has spread and can be said to constitute prevailing modern investment treaty practice. Second, investment treaties have moved from an exclusively inter-governmental model reflecting the pole position then of nation states to a mixed model where private claimants have the right to initiate and conduct arbitral litigation with little, and often no intervention powers exercisable on the intergovernmental level. That means that the screening, filtering and sponsoring function of the home state has largely disappeared (less so in Nafta Chapter XI investment arbitration). Also, the format of investment-related arrangements has evolved from straight concession agreements or formal investment and state contracts towards complex packages where contracts are concluded with state agencies and enterprises, regulatory authorities and private parties (financiers, banks, suppliers, purchasers) and where the state involvement is often rather by regulatory power than by state ownership or direct contractual participation.

The solution proposed as a result of this study differs from the outright "rejectionist" approach of the SGS v Pakistan tribunal, but also from the in terms of result similar reductionist outcome reached by the SGS

v Philippines tribunal – where in effect domestic jurisdiction clauses are allowed to prevail over the rejection of "exhaustion of domestic remedies" and the prohibition of waivers of BIT protection thus going counter to the original intention of the pacta sunt servanda clause. The conclusion of this study goes reverts to the original intention – but also the then not always explicit assumptions of the drafters of this clause: The principle that international law would only protect breaches and interference with contracts made with government – or subject to government powers, if the government exercised its particular sovereign prerogatives to escape from its contractual commitment or to interfere in a substantial way with such commitments. This applies as well to contracts concluded only with private counter-parties in the host state if such contracts are destroyed by government powers. All these cases constitute a sub-discipline of the overarching principle that proprietary rights should not be "taken" without adequate compensation.

The study suggests that it is inherent in the logic of such contract protection against governmental intervention that contracts that are "merely commercial" , concluded with the state as "fisc" are not covered by the clause. If the core or centre of gravity of a dispute is not about the exercise of governmental powers or reliance on governmental prerogatives and natural advantages, but about "normal" contract disputes, then the BIT and the umbrella clause has no role. Such disputes fall under whatever jurisdiction exists. It is only when state courts exercise such jurisdiction in a way that breaches a BIT that a BIT discipline comes again into play – relying, for example, on the "denial of justice" and "due process" principles.

This method of application for the pacta sunt servanda clauses also involves a two-tier method of rebuttable presumptions: On the first level, the involvement of entities that are state-controlled (structural test) and exercise in some way and to some extent public functions (functional test) suggests, prima facie, that the relationship is coloured by the involvement of government. On the second level, the alleged misconduct or breach must also involve more than merely normal contractual non-performance. If the state exercises its administrative and regulatory powers in a way that is related to the alleged misconduct or breach, that creates a presumption that the alleged misconduct displays enough governmental character. There are – as in another context developed in particular by the Maffezini v Spain and Salini v Morocco tribunals – a number of indicators which can help to qualify the alleged misconduct: Heavy politicisation, involvement of

senior government officials, public service function, absence of a true market-economy conduct, deeply regulated transactions suggest we have a governmental conduct. ON the other hand, if state-owned entities behave as normal investors (market-investor conduct), then, even if they allegedly breach their contractual commitments, there is no governmental intervention at play and the BIT protection can not be triggered. Such criteria do justice to the original intention of the pacta sunt servanda clause in investment treaties, and to the continuing intention of investment treaties to discipline government conduct which abuses its powers in respect to contractual relationships of foreign investors, but not to get involved in normal commercial conduct just because there is involvement of a state and a foreign company.

Tw: p of dissent, perhaps: waiting period – indications of abuse, use denial of justice