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Research Report

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Rethinking umbrella clauses in international investment agreements

by

Julien Chaisse*

While umbrella clauses are a common feature in international investment agreements (IIAs), their implications are far from straightforward or universally beneficial. These clauses allow private investors to escalate contract breach claims arising from the exercise of sovereign authority or power, to treaty violation claims, thus making international arbitration a possible route for dispute resolution.

However, the assumption that such clauses invariably fortify protection for foreign investors is not without contention. In fact, the incorporation of umbrella clauses often leads to a complex entanglement of legal and contractual obligations, creating an environment ripe for potential misuse and misunderstanding. As such, the perceived value and efficacy of these clauses merit closer examination and a more critical discourse.

The key concern is the determination of whether commercial commitments are encompassed within an umbrella clause's scope. In some cases, such as [Salini v Jordan](#), [El Paso v Argentina](#) and [Siemens v Argentina](#), the tribunals held that only when states exercise sovereign authority do they assume obligation under IIAs. Not all rely on this "sovereign authority" requirement; but when they do, tribunals have conflicting views on sovereign authority, especially regarding attribution. In [Hamester v Ghana](#), Cocomod's breach was not attributable to Ghana, while in [Kardossopoulos v Georgia](#), it was held that contractual commitments entered into by state-owned entities could be attributed to Georgia. In both cases, tribunals relied on [Articles on Responsibility of States for Internationally Wrongful Acts](#).

If there is a forum-selection clause in a contract, the umbrella clause must be superseded to establish jurisdiction. However, at present, the applicability of contractual forum-selection clauses is uncertain. The tribunal in [SGS v Pakistan](#) held that an umbrella clause does not automatically elevate a contract breach to a treaty violation when a contract contained a valid

forum-selection clause. The tribunal in [*SGS v Philippines*](#) determined that the exclusive forum-selection clause in the contract rendered the contractual claims inadmissible before the tribunal, although it did not otherwise deprive it of jurisdiction. The tribunal in [*BIVAC v Paraguay*](#) permitted the use of a forum-selection clause to prevent the misuse of an umbrella clause.

Finally, there is the question of whether investors that are parties to contracts with sub-national entities can use umbrella clauses. In [*Azurix v Argentina*](#), the tribunal held that the Province of Buenos Aires was party to the contract, and Argentina had not undertaken any obligations due to the lack of privity between itself and the investor.

Umbrella clauses breed unpredictability and inconsistent outcomes, influenced by external factors. Case-by-case interpretations by tribunals have resulted in conflicting rulings and ignited extensive debates, intensifying legal complexity.

Accordingly, and as a prudent policy recommendation, new IIAs should steer clear of umbrella clauses. Encouragingly, recent IIAs increasingly omit these clauses, reflecting a positive trend.

However, complete elimination in the near future is unlikely due to their interaction with most-favored-nation clauses, enabling investors to incorporate comprehensive umbrella clauses into other agreements. Therefore, countries should prioritize refining the negotiation, formulation and implementation of umbrella clauses with three main considerations in mind:

Aspects related to inter-departmental coordination and negotiation:

- As state contracts are negotiated by line ministries, IIA negotiators should liaise with these ministries to monitor potential interactions between state contracts and IIAs. Moreover, line ministries should negotiate state contracts in light of a country's existing IIAs and umbrella clauses.

Clarity in drafting IIAs:

- Reforming IIAs going forward, umbrella clauses should explicitly state which types of breach are outside the scope of the clause.
- IIAs should clearly state that a forum-selection clause supersedes an umbrella clause.
- The inclusion of an MFN clause in a new IIA should explicitly state that it does not apply to umbrella clauses in other agreements.
- All terms used should be properly defined, leaving little doubt as to whether a state is a party to contracts between sub-national entities and investors. However, the language should be carefully chosen to clearly show intent.

Scope of IIAs in protecting different interests:

- IIAs should enshrine the possibility of excluding certain investor protection standards from specific types of state contracts, for example, those based on industry or investment size.
- The inclusion of national security and public policy exceptions within an IIA may be sufficient [to protect regulatory discretion](#), even in a treaty regime that is otherwise expansively protective of state contracts.

In conclusion, two strategic policy directions are suggested. The first emphasizes the crucial need for host countries to exercise prudence before signing IIAs, ensuring they negotiate the provisions that are essential to protect their interests, which may include the explicit avoidance of an umbrella clause. The second strategy suggests that, if the omission of an umbrella clause is unattainable, any forthcoming clause of this kind should be meticulously crafted to navigate the inherent intricacies and uncertainties that it entails. This presents a significant challenge for policymakers. Collectively, the recommendations outlined above aim to bolster the transparency, predictability and precision of these agreements, thereby reducing potential legal ambiguities and fostering a more predictable investment environment.

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