A CRITICAL ANALYSIS OF THE SGS v. PAKISTAN AND SGS v. PHILIPPINES CASES: IN LIGHT OF THE CONFLICT BETWEEN UMBRELLA CLAUSES AND EXCLUSIVE JURISDICTION CLAUSES

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ABSTRACT

A Bilateral Investment Treaty is a treaty entered between two states that seeks to govern their relationship with respect to protection and promotion of foreign investments of entities of one party, known as the investor in the territory of another party, known as the host country. Every BIT comprises of a dispute resolution clause that proposes a mechanism to resolve the dispute that arises between the parties in a forum that is mutually consented to by both the parties such as the ICSID. At the same time, it is possible for both the parties to enter into a contract with each other which comprises of an exclusive jurisdiction clause that submits the dispute to the jurisdiction to the national courts of the host country. The first problem countered by the tribunal is to assess whether the dispute is based on a treaty breach or a purely contractual breach. In the case of SGS v. Pakistan, the tribunal held that all breaches arising from an underlying contract are purely contractual breaches and hence the exclusive jurisdiction clause was given precedence over the umbrella clause, a clause used to elevate all breaches, contractual or non-contractual as treaty breach. But in the case of SGS v. Philippines, the facts and circumstances being similar to the SGS v. Pakistan case, the tribunal held that claims amounting to treaty breaches, though arising from an underlying contract are still admissible. Thus, the tribunal accepted jurisdiction but declined to hear the merits of the case as it yet gave precedence to the exclusive jurisdiction clause.

Through the course of this paper, the author first seeks to expound the on concept of a bilateral investment treaty – its objective and purpose. Secondly, the author explores the concept of an umbrella clause and its necessity in the BIT. Lastly, the focus of the paper lies in the critical analysis of the two SGS cases which have presented the legal world of international investment jurisprudence with contradictory judgements and reasoning but upholding very similar outcomes,
leaving a set of unanswered questions and complexities. The author tries to answer the question as to what could have been the best possible outcomes in the judgements by filling in the logical fallacies and seeking to make it logically consistent.

**Key-words:** Bilateral Investment Treaty, Umbrella Clause, Exclusive Jurisdiction clause, treaty breach, contractual breach.
INTRODUCTION

Bilateral Investment Treaties, which seek to govern the relationship between the investors of one state and the government of another, are significant to the development of international investment law. The purpose of a BIT is to provide protection to investors in a foreign environment which on the outset is unpredictable—the primary reason hindering foreign investment. Bilateral Investment Treaties facilitate stability and guarantee investors of remedy against any hostile treatment meted out to them such as unfair and unequitable treatment or unlawful expropriation. A BIT is an effective tool to promote foreign investment, an essential for economic growth in the era of globalization and liberalization.

The presence of dispute resolution clauses in the BIT attracts the jurisdiction of the International Centre for the Settlement of Investment Disputes (ICSID) arbitration. ICSID arbitration arises in two situations.

The first, when a breach of treaty exists between the two parties where one party is the investor who contracts with a private enterprise belonging to the host country. The second situation is when an investor contracts with the host country by way of a contract, there exist two claims; contractual claims and treaty-based claims.

The conflict that the Tribunal is confronted with is whether it has jurisdiction in disputes arising from purely contractual based claims or whether the jurisdiction of the tribunal is restricted to treaty-based violations. In the event the latter is accepted as the general norm, the tribunal is challenged with the task of assessing whether contractual breaches amount to treaty violations where such treaty claims made by the investor arise from an underlying contract. Furthermore, conflict ensues where the Tribunal must solve the legal dilemma pertaining to the dispute resolution clause in the contract. Every such contract contains a dispute resolution clause whereby parties mutually agree to submit to the exclusive jurisdiction of the host country’s national courts.

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1 RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES, xii (1995).
4 Id. At 525.
or tribunals. Thus, in the case where contractual breaches amount to treaty-based violations, it is for the Tribunal to decide whether the dispute resolution clause as given in the contract must be adhered to or whether the dispute must be submitted to the jurisdiction of a neutral forum such as provided in the BIT. This decision of the Tribunal is reached by ascertaining the common intention of the parties by deciphering the wordings of the treaty.

It has been observed in international law jurisprudence that tribunals have jurisdiction over BIT claims notwithstanding a forum-selection clause in the contract. But the recent ICSID arbitration cases have reached contrary conclusions regarding whether a tribunal has jurisdiction to decide an investor’s contract-based claims. The comparative and critical analysis of these S.G.S cases is the primary focus of this article.

The facts and circumstances of both the cases being alike, it was argued by the investor in both the cases that the presence of the umbrella clause in the BIT allows ‘all disputes’ to be submitted to the jurisdiction of the Tribunal. By virtue of the umbrella clause, all contractual disputes irrespective of whether they amount to treaty violations come within the ambit of the BIT. Further, the umbrella clause is a provision enabling the investor to reject the jurisdiction of the national courts of the host country, overriding the exclusive jurisdiction clause in the contract.

Where in the case of SGS v. Pakistan, the tribunal rejected jurisdiction, the tribunal in the case of SGS v. Philippines, the tribunal accepted jurisdiction but refused to hear the case on merits. The paper seeks to explore the reasoning that led to such inconsistency between the two leading cases in international investment law.

UMBRELLA CLAUSE: THE HISTORY AND LITERATURE

A contentious issue that has come about in arbitration is the proper construction of the “umbrella clause,” which is a provision found in numerous BITs that compel a requirement on each of the Contracting States to observe all investment obligations entered into with investors from the other

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5 SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, Decision of the Tribunal on Objections to Jurisdiction, ICSID Case No. ARB/01/13, para. 157 (2002) (providing for dispute resolution in a forum other than a Pakistani arbitration tribunal would have been a —deal breaker for host country Pakistan.).

Contracting State. The fundamental purpose of an umbrella clause is to impose an international treaty obligation on host countries that requires them to respect obligations that they have entered into with respect to investment protected by the treaty.

The first occurrence of the “umbrella clause” as a distinct investment protection clause can be traced to the 1956-59 Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries (the Abs draft) (article 4).

The umbrella provision establishes an exception to an existing principle of international law concerning state contracts with, and obligation to, foreign investors. An umbrella clause may be worded in an all-inclusive manner by resorting to the usage of terminology such as ‘all disputes’. In cases such as SGS v. Philippines and BIVAC v Paraguay, the phrase ‘any obligation’ was interpreted broadly and was considered as an all-encompassing clause, not restricted to non-contractual claims treaty claims.

It is possible that, an umbrella clause can elevate a contract claim to the level of a treaty claim. Typically, violating a contract does not always invoke treaty protection under international law. However, adding an umbrella clause to a BIT effectively avoid that customary limit by expressly stating that a violation of an investment contract is deemed a violation of the BIT.

Further, the clause also does away with the need for investors to depend on the dispute resolution clauses in an investment contract, including clauses that reserve exclusive jurisdiction to local tribunals or courts.

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9 See H.J. Abs “Proposals for Improving the Protection of Private Foreign Investments”, In Institut International d’Etudes Bancaires, Rotterdam (1958).
10AZZIMUDDIN, supra note 8.
12 SGS v Philippines, supra note 5 at 115, 119.
13Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC BV v. Republic of Paraguay, ICSID Case No ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009 [141].
The provision also permits an investor to bring the claim before an international arbitral body, such as the International Centre for Settlement of Investment Disputes (ICSID).  

THE ANALYSIS

(a) The SGS v. Pakistan approach

The dispute between SGS Société Générale de Surveillance S.A. and the Islamic Republic of Pakistan arose from a Pre-Shipment Inspection (PSI) Agreement the two parties signed in 1994. Apart from BIT violations of not affording fair and equitable treatment and unlawfully expropriating the investors’ property, the investor also contended that there has been a violation of Article 11 of the BIT.

It was the counter argument of Pakistan that such a contention stands invalid, for purely contractual claims not amounting to BIT violations are without the ambit of the BIT. Further, the exclusive jurisdiction clause in the contract bars the Tribunal from exercising its jurisdiction over the case. Hence, the Tribunal is not the competent authority to decide the case.

It was at this juncture the Tribunal had to analyze the effect of the umbrella clause in the Swiss-Pakistan BIT in the form of Article 11 which read as follows: “Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party.” SGS contested that Article 11, was an umbrella clause that elevated purely contractual claims to BIT claims.

The tribunal rejected the arguments of SGS and declined jurisdiction. The decision of the Tribunal was based on the reasoning that a purely contractual claim is substantially different from a treaty claim and that the mere presence of an umbrella clause in the BIT is grossly insufficient to elevate contractual claims into treaty claims.

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15 SGS v. Pakistan, supra note 5, at 11.
16 Switzerland-Pakistan BIT, art. 11.
17 SGS v. Pakistan, supra note 5, at 54.
18 SGS v. Pakistan, supra note 5, at 173.
The first reasoning advanced by the tribunal in pursuance of its decision was that every violation of a contractual agreement, is not a violation of international law per se.\textsuperscript{19} This concept is valid and legally sound only in the absence of an umbrella clause. It is to be noted that where the parties had expressly mentioned in the form of Article 11 that all contractual commitments are to be observed by the parties then it is safe to presume that such an expression was the common intention of the parties to elevate contractual breaches to BIT breaches. It is accepted that where there is no umbrella clause in the treaty then such absence cannot be used to the advantage of the investors though it is open to interpretation.

Further, Article 31 of the Vienna Convention on the Law of Treaties\textsuperscript{20} clearly states that a treaty must be interpreted in good faith according to the ordinary meaning and in light of its object and purpose. The general rule of interpretation emphasizes on the common intention of parties.

Where the purpose of an umbrella clause is based on the ‘elevation theory’, the reasoning of the tribunal defeats the very objective of the clause. The tribunal has not only acted against the spirit of the law but also against the letter of the law. It is highlighted that if any such contrary intention to restrict BIT claims to treaty claims were present, then such intention would have been explicitly mentioned by the parties in the BIT. In the present case, any violation of a contractual agreement, irrespective of whether such breach amounts to a treaty breach, it will constitute a violation of the BIT and a subsequent international law obligation.

The second argument advanced by the tribunal was that a broad interpretation of an umbrella clause would override forum-selection clauses in investor-state conflicts.\textsuperscript{21} This concern of the tribunal is based on the unfounded belief that acceptance of a contract claim based on the umbrella clause requires interpretation and resolution of the contractual dispute. This is clarified partially in the case of \textit{SGS v. Philippines} where it was established by the tribunal that in cases where contractual breaches amount to treaty violations then it is the burden of the tribunal to only resolve matters related to the BIT and not settle the contractual disputes.

The tribunal based its judgement on the ‘fundamental basis’ test. They held that the tribunal could exercise jurisdiction in cases only where the fundamental basis of the claim made by the investors

\textsuperscript{19} SGS v. Pakistan, \textit{supra} note 5, at 167.
\textsuperscript{21} SGS v. Pakistan, \textit{supra} note 5, at. 168.
were treaty based. The tribunal did not recognize the wide ambit of claims that are made by investors. They failed to differentiate purely contractual claims as against treaty claims arising from underlying contracts. The tribunal has faulted in this regard by treating the latter an equivalent to the former.

(b) The SGS v. Philippines approach

The dispute of SGS Société Générale de Surveillance S.A. and the Republic of the Philippines was based on a contract referred as Comprehensive Import Supervision Service (CISS), the purpose being the provision of pre-shipment inspection services of the Philippines’ imports in the country of supply, including verification of the imports’ quality, quantity, and price.22

Having renewed the contract twice, in 2000 the contract was discontinued by the Philippines government. The investor filed for payment of unpaid dues for services provided amounting to an approximate of US $140 million plus interest.23 SGS not only contended BIT violations of denying fair and equitable treatment and unlawful expropriation of the investor’s property, but also submitted that there was a violation of Article 10 of the Swiss-Philippines BIT.24

Similar to the counter arguments proposed by Pakistan, Philippines argued on parallel lines where they contested jurisdiction firstly, due to the purely contractual nature of the claims and secondly, the presence of the exclusive jurisdiction clause in the contract barring jurisdiction of the ICSID and submission of the claim to the national courts of Philippines.25

The decision of the tribunal was contradictory to the judgement of the SGS v. Pakistan case. On one hand, where the tribunal accepted the jurisdiction of the dispute, it refused to hear the arguments on merits.

The decision of the tribunal is significantly disparate to the SGS v. Pakistan case in terms of the tribunal recognizing the dissimilarity between the concept of purely contractual claims and treaty claims arising from underlying contracts. The tribunal adopted a broader interpretation of the umbrella clause, though not in absolute totality.

22 SGS v. Philippines, supra note 6, at 12–13.
23 SGS v. Philippines, supra note 6, at 15.
24 SGS v. Philippines, supra note 6, at 16.
25 SGS v. Philippines, supra note 6, at 113, 160.
Where in the case of Pakistan, the tribunal failed to elevate all contractual claims, the Philippines tribunal adhered to respect the umbrella clause under certain conditions. They did not provide a blanket immunity to investors against all claims but only to those contractual claims that are inseparable from the treaty claims. The tribunal expounded that in situations where it is impossible for the investor to establish a treaty breach without elaborating on the underlying contractual breach, such contractual breach would call for the application of the umbrella clause.

The reasoning of the tribunal is two edged. Though the judgement opened doors for a broader interpretation in comparison to its precedent, it neither did adhere to the spirit nor the letter of the law, where the two in this case, are indistinguishable. Where there is a lack of a contrary intention expressed accompanied with the explicit intention of elevation, it is unjustified for the tribunal to impose a burden on the parties with respect to the interpretation of unambiguous clauses in the BIT mutually consented by both the parties.

But the reasoning afforded by the tribunal for such partial elevation is not unfounded and legally unsound as for disputes that are purely contractual in nature, the terms and conditions of the contract are applicable. It is unfair for the tribunal to impose unnecessary burden on the host country in the form of additional protections afforded in the BIT apart from the existing protections in the contract. But this reasoning of the tribunal though not legally inapposite, it is inapplicable in the present case for the reasons aforementioned. It is applicable in disputes between parties where they have not expressly consented to the adherence of umbrella clauses in the BIT.

Furthermore, where the tribunal accepted the jurisdiction but did not hear the case on merits, the decision is criticized on the ground that it presents a conflicting approach in the disposal of the case. The reason cited by the tribunal was to give effect to the forum selection clause in the contract.

Where the author believes that in the present case, all contractual claims should have been elevated to treaty claims without the imposition of any restrictions or conditions, the question of adhering to the exclusive jurisdiction clause does not arise. The dispute resolution clause in the BIT must take precedence over the forum selection clause, though the latter was also mutually consented by the parties. The reason is traced back to the purpose of the BIT which sought to afford protection
to foreign investors and provide an impetus to foreign investments.\textsuperscript{26} It was the sheer incapacity of contractual arrangements between parties belonging to different nationalities to solve disputes that gave rise to the creation of Bilateral Investment Treaties. The objectives were twofold: maintaining a balance between protection to foreign investors and respecting state sovereignty and their right to regulate as well as providing a neutral unbiased forum for the settlement and resolution of disputes. The latter objective is an essential for a just and fair hearing. It is imperative for the tribunal to look beyond contractual clauses where there simultaneously exists a BIT governing the two parties to the contract, bearing in mind, that the two parties in question are not enterprises of one state.

Similarly, even in the event where acceptance of jurisdiction is restricted to contractual claims amounting to breach of treaty claims and not purely contractual claims, for the reasoning aforementioned, the dispute resolution clause in the BIT must be given precedence over the exclusive jurisdiction clause in the contract. Rejecting arguments on merits after accepting jurisdiction due to obedience of the forum selection clause indicates logical fallacy in the decision. The very purpose of establishing jurisdiction by one party is for the case to be heard on its merits for its disposal.

CONCLUSION

The SGS cases have adopted diverse approaches in the method of interpretation where the Pakistan judgement resorted to a narrow interpretation of the clause and the Philippines decision reflected a broad interpretation of the same.

In conclusion, the \textit{SGS v. Philippines} case explored a new concept of framework in decision making by accepting jurisdiction and rejecting merits. Though the tribunal adopted a middle ground approach in resolving the issue, it has increased complexities in international investment law jurisprudence with respect to the conflict between an umbrella clause in the BIT and exclusive jurisdiction clause in the contract.

Despite adopting a comparatively broad interpretation of the umbrella clause and expounding on a new reasoning for the same, by denying merits of the case, the tribunal has failed to uphold the case as a strong precedent in the matter resolving the conflict. In fact, it raises question and doubt regarding the role of international law forums as bearers of justice who no longer may be the appropriate forum for the investors to approach despite their presence in the dispute resolution clause in the BIT. The judgement, to an extent, has rendered the role and purpose of these forums as futile.

It is appreciated that an expanded interpretation compared to that assumed in the SGS v. Pakistan case has been accepted in the Philippines case, it is pertinent to note that both tribunals have ignored the purpose of the clause and the intention of parties, the tribunals have acted against the spirit and letter of the law.
REFERENCES


