
Analysis of Legal Effects of Umbrella Clauses on Bilateral Foreign Investment Treaties

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ABSTRACT

Umbrella clause sometimes referred to as being loyal to commitment, obligation consideration clause or good-will clause in contracts is a kind of clause present in many bilateral foreign investment treaties and Multi-lateral Energy Charter as well. Despite the fact that umbrella clauses contained in treaties are quite similar and alike, their exact expressions might be a bit different from a treaty to another bilateral foreign investment. This difference among expressions and vocabularies could be the root cause of their various interpretations. Umbrella clause is a legal means set by capital-exporting countries in bilateral investment treaties to support foreign investors and promote the violation from agreement provision to bilateral treaty provisions and consequently modify the source of trials.

Keywords: Bilateral Treaties, International Investment, Umbrella Clause.

Introduction

International investment refers to a kind of operation within which the investor imports something to a country where he/she has no previous legal relationship (citizenship or residence) with. Host country can always set certain rules on the access of foreign investors due to sovereignty right, political and/or economic reasons. Investment is counted as an international trade and in fact foreign investment is the pre-requisite for international trade activities. Generally speaking, "it is safe to say that policy makers of any country must adjust the foreign investment policies based upon country's given needs so that they enjoy the highest profitability coming from the investments by

multi-national factories." Encyclopedia of Public International Law, Vol. 8, P. 246.

Previously, the judgment mechanism or host country's trial laws were used to settle the dispute. Over time, capital-exporting countries realized that such a mechanism cannot guarantee their interests since the host countries' trial resources are usually impacted by national interests when it comes to propose a verdict. Therefore, developing countries which are basically considered to be of capital-exporting ones awakened and attempted to fill this gap. They went for fixing these problems to a certain extent by designing multi/bi-lateral foreign investment treaties or establishing international agencies

like multilateral agency for guaranteeing foreign investment.

Review of the Related Literature

Umbrella clause is the subject of legal debate and dispute in recent years among arbitration circles and courts. This argument happened for the first time in 2003 in the case of the Swiss company SGS with Pakistani government. Although its history in bilateral investment treaties dates back to 1959, today a significant number of bilateral investment treaties contain umbrella clauses. It is also included in most of the bilateral investment treaties signed with other nations. In Iran, about 80 percent of bilateral investment treaties contain umbrella clause.

“Umbrella clause is one of the fundamental rules of the organization for Economic Cooperation and Development on the Protection Convention of Foreign Property in 1967, 2nd article of which stipulates that “each of the parties must continually ensure the commitment observance on the ownership of the nationals of the other party.”

The Concept and Nature of Umbrella Clause

Umbrella clause in bilateral investment treaties is a legal means employed by international investors and their countries of interest to restrict the nations in applying State policies and keeping foreign investors out of internal rights monitoring. Foreign investment contracts between developing countries and foreign entities, whether of rating or other types, are in principle private contracts. According to investors and their respective States, internal rights monitoring of these contracts would authorize the State to intervene for they are always able to undermine the investment and related contracts' stability with new legislation and thus ignore the investors' interest. Therefore, in order to protect their citizens' interest

investing in other countries, the capital-exporting States when designing bilateral investment treaty stipulate a clause or condition which ensures all the obligations of the parties on the investment. In fact, the purpose of inclusion of the umbrella clause with the bilateral investment treaty is to stress the permanent support of investment treaties. Where such obligations are ignored by the host country, one can say that the obligations included in the treaty have been violated.

In bilateral investment treaties, umbrella clause has been used as follows: each of the parties to the treaty shall ensure and comply with any obligation that might be binding to act about the States' or other companies' investment. This rule is widely stated so it can potentially cover all kinds of obligations, that is, both contractual and non-contractual obligations.

But, concerning umbrella clause, there are some important consideration. First, for western lawyers, umbrella clause means that the State parties' obligations in investment contracts which are in principle private promote to the international obligations. Second, if umbrella clause refers to respect to the State obligations in private contracts, dispute settlement in private contract also belongs to the same obligations so imposing other obligations to the State in a private contract and dispute settlement clause are impossible. Third, the nature of compensation for violation of international law is different from that of private contracts.

The Importance of Umbrella Clause Literature in Bilateral Investment Treaties

A comparative analysis of umbrella clause reveals their common features. Of course, there is a general difference, especially in terms of the use of literature exists to the question of the scope and the effect of umbrella clauses. Arbitration procedure and

theories raised by lawyers requires that each clause should be interpreted according to its terms and conditions so that the terms and literature of umbrella clauses definitely identify the scope and the effect of the clause. In particular, the following issues are related to the topic of umbrella clauses.

1. What obligations are supported by umbrella clauses?
2. Which investor can enjoy the support of umbrella clause?
3. What influence does umbrella clause interpretation have on the investment agreement between the investor and the host government?

First, as a general rule, the common and general factor among all umbrella clauses is the use of authoritative and essential statements and literature. For instance, paragraph 4, article 8 from Germany bilateral investment treaty in 1991-1992 stipulates that: each of the parties shall ensure and follow any obligations about investments in scope of which treaty is done by nationals or companies of other parties.

In article 10 on bilateral investment treaty between Poland-Australia in 1991, the form and combination of the expressions used are somewhat different from other treaties since there is less necessity on the combination of words and expressions.

“One treaty party must employ all its might and power based on its rules to ensure and respect a written treaty granted by an authority to another national on investment.” Secondly, the second feature analyzed for the majority of bilateral investment treaties is that it relates to the obligations taken by the government and does not refer to the obligations between private parties.

The Scope and the Effect of Umbrella Clause

One topic of discussion on umbrella clause is the scope and extent of its obligations. There are different statements as “any obligation”,

“any other obligation” among umbrella clauses. It is noticeable that the expression of “any obligation” in the Euriko verdict against Poland was obvious. International Center for Settlement of Investment Disputes (ICSID) held that: “any obligation” expression is highly widespread and it contains not only special obligations but also the word “any” addresses all obligations. It is clear that some umbrella clauses merely refer to government binding obligations whereas some others refer to obligations of the government.

Finland bilateral investment treaty refers to the obligations this government might take on about a given investment. Such phrasal differences raise the question of whether this obligation is a contractual one between the State and the investor or not? And can the expression of “any obligation” be extended to the unilaterally State obligations through legal procedures and administrative measures? Some lawyers believe that the expression of “commitments entered into” might be interpreted as the obligations taken against other party. In the case of SGS against Pakistan, ICSID announced: the expression of “commitments entered into” is so widespread that the State unilaterally obligations include municipal and administrative actions and measures.

International Center for Settlement of Investment Dispute (ICSID)

World Bank Center, which settles investment disputes, as its name suggests does not play a role in the nature of investment and ease of enforcement. Therefore, this center provides some kind of peace of mind for international investors and paves the way to sign international bilateral treaties and investment treaties and finally leads to the development of international investment. There are many countries from both capital-exporting and capital-importing which have membership of ICSID. This helps the investors take higher chances and go for

investing in the member countries. ICSID has got two types of facilities: first, major mission: refers to the settlement of investment disputes between a State and citizens of another State. A second, extra facility which was later added to the center in the 1978 and includes those items that are explicitly mentioned in the Convention. They are as follows: 1. Trust-seeking system. 2. Arbitration and compensation between the parties of a dispute in which one is not a member of the Convention or nationals of a Member State. 3. Disputes not directly belong to investment but the main contract is the same as the investment one. ICSID center has formulated some rules for these disputes and provided facilities available for parties involved.

Interpretation of Contracts and Treaties

What is to be analyzed here is the principles used for interpreting contracts and treaties and if ICSID center has complied with these principles or not. This issue is presented in two sections. A primarily issue of contract interpretation is checked, and then the rules and issues governing the interpretation of treaties is explored.

Paragraph 1: Contract Interpretation

Interpretation is located on the bond and performance of the contract. Where ambiguity, lack of affirmation or contradiction, results in ambiguity in the rules of contract, interpretation is necessary. The parties attempt to specify their intentions with the help of interpretation, correspond their own behavior and to make it possible signing a comprehensive contract. More importantly, the need for a conventional interpretation to convince the other party in mediation or litigation, as well as to convince the judges and the referee is no secret.

Internal Contracts

To interpret the internal contracts, one can say that although the States increasingly intervention has reduced the authority and common will of the parties in respect to keeping discipline and expedient of the society, common interest ruling is still credible and the core axis of contract interpretation for common interest is the parties involved. Also the purpose of interpretation is to discover the characteristics of the contract to see if it corresponds with the parties' will. Contrary to what is sometimes thought, in Iran's current law system, the parties' common interest forms the core of contract interpretation not the social interests or fairness which are instances of ambiguity. (Dr. Mehdi Shiri, Principles of contracts and obligations, law era, 1st edition).

In French, contrary to Iranian law, contract interpretation in the State's civil law bears an independent title and its due regulations have been mentioned in 1135 and mainly 1156-1164 articles. Some French civil rights writers, when it comes to contract interpretation, identify regulation articles as the purpose of interpretation.

In International Convention of Vienna in 1980, article 8 refers to contract interpretation (Dr. Mehdi Shiri, *Ibid.*, PP. 313-16). The key to interpret the other current legal systems is principally based on the common will of the people who have signed it.

According to article 8 of the International Convention of Vienna, speech and action of each party must be the basis of interpretation whether the other one has known it or not. Therefore, will is the principle and circuit of interpretation in the convention.

International Contracts

There are somehow systematic rules for contract interpretation in all national laws.

Sometimes, such rules are interpreted by a judge, as in England where its judicial procedure takes the objective approach for contract interpretation and recognizes valid the kind understanding a typical individual reaches to in light of such contractual documents and due relevant events. Sometimes, these rules are expressed by legislators such as France where for articles 1156 to 1164, civil law and personal interpretation are preferred.

It is worth noting that various interpretation rules offer specific face to international contracts. First is valid contract which stresses on the validity of the contract and supports a kind of interpretation which keeps the contract coherence and its effective interpretation. Then, there are specific rules concerning the difference among various language versions of the contract which the parties intend to recognize them all valid. The rule is interpretation based on the original version which is superior.

Finally, procedures and practices established regarding the interpretation of international contracts is that if a contract clause is missing, the judge or arbitrator is authorized to compensate it with a good "implied clause." Of course, the judge will proceed to complete the contract only when there is a common need around (Oliver Kasha, Translator: RsoulRezaie, Ibid., P. 452).

Paragraph 2: Interpretation of Treaties

Treaty interpretation is a rational activity which is done to properly understand and clarify the meaning and the scope of the treaty. According to George Cell, interpretation and components of legal rules though seem as a united method in practice, there are logically different since one has to understand the limits of the rule before it is enforced and then it must be matched with the case. That is the reason why one can never claim that a rule has been enforced without interpretation even when the logic

and concept of the rule is crystal clear. (ZiyaieBigdeli, Mohammad Reza (1379), General International Law, P. 356."

Interpretation bears a vocative nature and its purpose is to deduce the concepts of a given text. Thus, it neither analyzes "what should be" nor reviews the rules and fills the gaps. Interpretation requires a text or in other words a principle. That is why it is limited to the true meaning and the precise scope of the rule.

Article 31 of the 1969 Vienna Convention along with stating the general rule of interpretation place the text of the contract as the basis and employ practical method, not the oral one, which is useful in many ways.

This method Comprises of Steps Given in this Article

1. Each treaty must be interpreted in light of its subject and purpose with good will based on the typical and conventional sense given to treaty phrases according to their register.
2. In the interpretation of any treaty, register includes the following items besides the text including the introduction and appendixes:
 - a. any relevant agreement that has come into existence due to signing a treaty between the parties.
 - b. any document that has been designed by a party or several parties to sign the treaty and other parties of the treaty accept it as a relevant document to the treaty.
3. Each term (word) is used in a certain sense if that proves to be the intention of the parties.
5. It is obvious that interpretation of a treaty, bilateral or multilateral, due agreements and documents be taken into consideration. Although each due document or agreement is not the inevitable part of the treaty, as the International Court of Justice has commented on one of the cases¹, it is part of the register

¹ International Justice Court about Ambatielos issue announced: declaration articles have got the same

and is so part of the general principle of interpretation.

Conclusions and Recommendations

Umbrella clause is an important and challenging issue which has raised interesting issues in recent years in legal circles and international arbitrations.

Umbrella clause in the bilateral investment treaty is a legal means used by international investors and capital-exporting countries to limit the capital-importing countries from applying State policies and to prevent investment treaties from instability. Over the last decade, foreign investors' and their countries of interest's mental concern has been that it is always possible for capital-importing countries which are a party in private investment contracts upset the stability of such contracts and weaken or distort the profitability and interest of investors through designing State rules through legislation procedure. Therefore, in the recent decades, foreign investors have used various legal means such as the inclusion of stabilization clause in the contract, international arbitrations clause for dispute settlement, internationalization of investment contracts like Jean RendehDapoupi, French lawyer in Texaco case (Texaco Oil Company against Libya) and finally umbrella clause with bilateral investment treaty. Given the analysis of the cases raised or still open in ICSID center, there are different ideas on the interpretation of umbrella clause. Lawyers usually have acted differently from western investors' and capital-exporting states' intentions in a way that they have been cautious about taking decisions on the interpretation of this clause though in some issues discussed there have been some agreements with their comments. Regardless of these challenging and stressful issues, Iran and other Persian Gulf States are

in short of advanced technology and facilities. Doing large industry, mining, exploration projects and extracting natural resources requires foreign investors' knowledge and technology. It is a good idea to comply internal rules with international standards and overcome all political obstacles so that foreign investors and Western countries appeal to invest in Iran. This is a method to keep legal disputes and issues away and help flourish the country.

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