Heikki Marjosola

PUBLIC/PRIVATE CONFLICT IN INVESTMENT TREATY ARBITRATION – A STUDY ON UMBRELLA CLAUSES
Public/Private Conflict in Investment Treaty Arbitration – a Study on Umbrella Clauses

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Heikki Marjosola

Abstract

In investment treaty arbitration a neutral international tribunal adjudicates an investment related dispute between a private foreign investor and the host state of the investment. Access to tribunal is usually granted in investment treaties. Treaties are generally in a bilateral form (Bilateral Investment Treaty, BIT). Investment treaty arbitration is in many ways an abnormal way of settling international disputes. It is not totally public, in that it does not concern a dispute between signatory states. It is also inevitably linked to the municipal law of the host states of the investments. However, investment treaty arbitration is not private either because by assessing alleged violations of treaty provisions by signatory states it, transcends the boundaries of international commercial arbitration.

Many investment treaties include umbrella clauses which create an obligation for the host-states of the investment to observe their obligations towards private investors. The nature of these obligations, however, can be subject to dispute. Whether a treaty protects e.g. the obligations stemming from investor-state contracts can become a puzzling question when a contract itself includes another forum for the settlement of disputes. These situations have resulted in jurisdictional conflicts which the tribunals have solved in an inconsistent manner.

This paper argues that this well-known inconsistency is rooted in the praxis of judging state conduct along sovereign/merchant lines. It is argued that this categorization of state conduct according to the arbitrary rubrics of “sovereign” or “commercial” is but a mirror image of public/private distinction of law constituted in classical legal thought. Accordingly, the jurisdictional conflict generated is here called a public/private conflict in investment treaty arbitration.
Full Article

1 Introduction

The purpose of investment treaties is to increase foreign investments by limiting a state’s arbitrary use of its powers against foreign investors. Perhaps the most important innovation of modern investment treaties has been the dispute settlement procedure they offer: investment treaty arbitration. In case of violations of their rights by the host states of investments, private investors are no longer required to plead on their home governments for diplomatic protection. Conversely, investment treaties usually confer on private investors a direct right to initiate objective international arbitration against the host states of their investments.

The balancing function of investment treaties is needed because the powers of investors and host-states are structurally asymmetrical. The heart of the asymmetry is that investors are subject to “exposure to the host state as contract party, regulator, sovereign and judge …”¹ The exponential growth in the number of investment treaties has also made the law on international investments subject for increasing interest, both academic and practical. The density of the network created mainly by Bilateral Investment Treaties (BIT) has even inspired some to speak of an emerging global regime.²

Because investment treaties set limits to state conduct, a foreign investment regime can be considered as public international law. However, investment treaties are “public” only to a limit. Investment treaties such as BITs also create private obligations between states and investors and as such, it is said, they “straddle the line between public and private law”.³ This paper discusses the controversial role that privately agreed obligations play in investment treaty arbitration and focuses on the different interpretations given to the so-called umbrella clauses. Many investment treaties include umbrella clauses which create an obligation for the host-states of the investment to observe their

¹ Wälde 2004a, p. 77.
² Salacuse 2007, p. 163.
obligations towards private investors from another contracting party. It is subject to debate what the nature of these obligations can be. Both academic writings and the reasoning of treaty tribunals vary greatly. A common impression has been that umbrella clauses address specific agreements between host states and foreign investors. These explicit agreements/contracts are also under the focus of this paper. However, umbrella clauses have had effects outside contractual obligations as well. This was the conclusion of the Tribunal e.g. in *LG&E v. Argentina*.

The umbrella clauses have materialised in jurisdictional conflicts which the tribunals have solved inconsistently. The conflicts can materialize when parties to the investment-related contract have agreed on another forum for solving potential disputes. Then, of the conflicting jurisdictions, the other is *the public*, concerning treaty-based investment protection vis-à-vis the host-state, and the other, *the private*, is primarily occupied by choice of law and forum selection rules which are questions answered on the level of municipal law and private international law. Accordingly, this conflict is here called a public/private conflict in investment treaty arbitration.

This paper studies different interpretations of umbrella clauses in light of a conceptual framework: It is argued that the highly subjective understandings of the public/private distinction of law give a conceptual framework for the interpretation of contract claims in investment treaty arbitration. The inconsistent rulings on the tribunals' jurisdiction on contract claims are rooted in the praxis of judging state conduct along sovereign/merchant lines. States possess a unique ability to inhabit both the spheres of public and private law. Categorizing state conduct according to the arbitral rubrics of “sovereign” or “commercial” represents a mirror image of the public/private distinction of law constituted in classical legal thought. This dichotomy

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4 Wordings of the umbrella clauses are diverse, but this “obligation to observe commitments” can be seen as some kind of a standard form.
5 *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*. ICSID Case No. ARB/02/1. In the case, the Tribunal considered that the gas law of Argentina could be interpreted as a specific obligation that had to be observed by the state, because gas law was specifically used to attract foreign investors.
6 Zachary Douglas calls these “symmetrical conflicts between jurisdictions”, in Douglas 2004, p. 239.
has been upheld already in the development of the doctrine of state responsibility for injuries caused for aliens.

A thorough analysis on the issue is of course out of the reach of this paper. Rather than even try to present a comprehensive review of the many cases regarding the extension of the jurisdiction of the investment treaty tribunals to contractual claims, this paper tries to present different approaches taken to this problem, particularly considering the different interpretations of the umbrella clauses.

2 The Enigmatic Umbrella Clause

2.1 Private Obligations Protected

It is said that there are two ways for foreign investors acting under the protection of an investment treaty to initiate international arbitration proceedings based on contract claims: Either the dispute resolution clause itself in the investment treaty is wide enough to encompass contract disputes as well or the investor whose rights have been violated by an alleged breach of a contract by a state can try to transform its claims from the contract level to the treaty level. The latter option is usually tried to be justified by umbrella clauses.

There are many formulations of umbrella clauses, not a single umbrella clause. Nevertheless, umbrella clauses are quite similar in their wordings. This is mainly because through model-BITs and other investment treaty models the formulations of the investment treaties are becoming more harmonized. However, such amount of divergence still exists that we cannot argue for universal understanding of an umbrella clause. When interpreting an umbrella clause included in an investment treaty, careful attention must be given to the specific language of the clause and to the context of the dis-

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7 A good and concise presentation of such cases can be found, e.g. in Schreuer 2005a.
8 The dispute settlement clause in the BIT between Argentina and France is a good example as it states that its provisions concern "any dispute relating to investment".
10 For Douglas "The striking feature of [...] the collection of model BITs is that their formal layout and substantive content are very similar, often practically identical, in spite of the different economic and cultural reality prevailing in the states in question". In Douglas 2004, p. 159.
pute to discern the intentions of the contracting states of the treaty. The different formulations of the umbrella clause are not of great interest here. As a point of reference, a widely used formula is included in the Energy Charter Treaty’s (ECT) article 10(1, last sentence):

“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.”

ECT’s umbrella clause represents an example of a very open umbrella clause. No explicit requirement is set for the “entered obligation” even to be related to the investment. This might give leeway for the interpretation of the extension of ECT’s protection to any agreements, no matter how insignificant commercially or otherwise, or how unrelated to the investment, the only requirement being the legal statuses of the parties as a “state” and a “foreign investor”. However, contextual reading of the ECT’s chapter 10 reveals that such extension would not respect the intentions of the treaty drafters.

Thus umbrella clauses address private agreements and obligations. It is rightly said that investment treaty arbitration has a hybrid or a sui generis character. Unlike any other dispute settlement procedure under international law, investment treaty arbitration is inextricably linked to the national legislation of the host state, since “it is […] the municipal law of the host state that determines whether a particular right in rem [subject to the protection by the investment treaty] exists, the scope of that right and in whom it vests”. Municipal law is an important part of the investment dispute also when the treaty tribunal is asked to adjudicate claims based partly or even completely on private agreements. The law applicable of the agreement cannot be put

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12 Many examples of umbrella clauses are included e.g. in the OECD 2008, see Annex 2.A1.
14 Generally umbrella clauses require the existence of a link between the entered obligation and investment for it to become effective, as e.g. in article 3(4) of the Netherlands model BIT: “Each contracting party shall observe any obligation it may have entered into with regard to investments […].”
a side. This has been recognized by treaty tribunals as well, e.g. in the case *SGS v. Philippines*.16

Umbrella clauses are said to be able to extend the commitments of the host state beyond traditional international standards by putting contractual arrangements and other promises under the protective ‘umbrella’ of the investment treaty17. Thereby it is generally agreed that umbrella clauses have an effect on privately agreed arrangements18. It is the question of how effective they are that scholars, tribunals and governments are disagreeing about.

The pending question could be put briefly as follows: Do treaty-based international arbitration tribunals have jurisdiction over private agreements between the investor and a host state, and if so, over what kind of agreements, to what extent, and in what kind of situations? It appears that there are as many answers to this question as there are parties but we can point out some divisions along which the opinions settle.

It must be noted that the history of modern umbrella clauses dates back to the 1950s and as such we are not dealing with a recent innovation in international law.19 And even though the discussion around umbrella clauses has intensified only relatively recently, this is not the first paper either to discuss the different points of view from which umbrella clauses are looked at20. Usually, the disagreeing parties can roughly be split into two. Others, sometimes accused of echoing the notorious “Calvo Clause”21, emphasize

16 *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*. ICSID Case No. ARB/02/6. The tribunal stated the inevitable effect of the national law in the case as follows: “Whether collateral guarantees, warranties or letters of comfort given by a host State to induce the entry of foreign investments are binding or not, i.e. whether they constitute genuine obligations or mere advertisements, will be a matter for determination under the applicable law, normally the law of the host State.”
17 Schreuer 2004, p. 250.
18 This *effet utile or the principle of effectiveness* requirement is stated in the article 31(1) of the Vienna Convention on the law of treaties. Treaty provisions should not be mere declarations without a genuine legal effect.
19 It is worth remembering that the historical roots of the modern umbrella clauses date back to the settlement of the Iranian oil nationalization dispute in 1954. See Sinclair 2004, p. 413-415. According to Sinclair this dispute was the first case in which a modern ‘umbrella treaty’ was employed, and it was primarily embodied in the advice given to the Anglo-Iranian Oil Company by Elihu Lauterpacht. However, the idea of the umbrella clause can be traced even further to the ‘early umbrella treaties’ of the 1920s.
21 The so called Calvo Clause in investment treaties aimed to restrict the means of foreign investors to recourse to international arbitration. Under the doctrine foreigners were to be treated in the same way as local nationals. This meant e.g. that foreigners had to pursue their rights in local courts. See Schreuer 2005b, note 11.
state sovereignty and hold that the law governing private contracts should be a purely domestic matter. Others oppose this view on the grounds of the needs of international commerce and the need to extend good governance to the global economy.22 Put like this the nature of the dispute seems to be essentially political. A less political way of separating the interpretations of umbrella clauses is the simple depiction of the interpretations as wide or narrow23 or integrative or disintegrative24. Somewhere between lies “the middle approach” which states that it is possible that a state’s violation of a contract with a foreign investor constitutes a breach of an investment treaty, that is, international law.

2.2 Some Inconsistent Tribunal Decisions

The advocates of the narrowest interpretation of the umbrella clause wish for a clean separation of treaty claims from contract claims. This has also been called the dualist approach, since it is said to rely on the positivist tradition of international law which holds that a systematic distinction should be maintained between municipal law governing contracts and international law governing treaties.25 This distinction was held firmly in the very first case where an umbrella clause was taken under the closer scrutiny of a Tribunal. In SGS v. Pakistan the Tribunal pointed out the well-known principle of customary international law according which “... under general international law, 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”26. The Tribunal was not convinced that a “single sentenced” umbrella clause was reason enough to deviate from the principle and held that:

“. . . the scope of Article 11 of the BIT [Switzerland-Pakistan BIT], while consisting in its entirety of only one sentence, appears susceptible of almost indefinite expansion. The text itself of Article 11 does not purport to state that breaches of contract alleged by an investor in relation to a contract it has concluded with a State (widely considered to be a matter

22 Wälde 2004b, p. 2–3.
23 OECD 2008.
24 Shany 2005.
of municipal rather than international law) are automatically “elevated” to the level of breaches of international treaty law.”

The Tribunal did its best to follow the general rule of interpretation of the treaties set in the Vienna Convention. However, after the decision, a letter turned up with Swiss authorities explaining their intentions when signing the BIT with Pakistan. According to them, article 11 (the umbrella clause) was intended to cover commitments “[…] which played a significant role in the investor’s decision to invest […] i.e. commitments which were of such a nature that the investor could rely on them […].” Thus it was the crucial expectations of the investors that were sought to be protected by the treaty. Whether these expectations were based on an assumption of non-interference by a state as a sovereign, or on an assumption of maintenance of stability of the necessary legal framework, or on positive promises of the state as a party to the contract, should not make a difference. The further reasoning of the courts and scholars has made it quite clear that an umbrella clause should not be deprived of all of its effect.

The interpretation of the umbrella clause was kept narrow also in *Joy Mining v. Egypt*. The Tribunal did, however, leave some interpretative room for the umbrella clause. It concluded that the umbrella clause should not be given an effect in the matter at hand, but continued:

“[…], unless of course there would be a clear violation of the Treaty rights and obligations or a violation of contract rights of such a magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect. This might be perfectly different in other cases where that link is found to exist, but certainly it is not the case here.”

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27 Ibid., para. 166.
28 Vienna Convention on the Law of Treaties, Article 31. According to the article 31(1), “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” However, the article (31(4)) also states that “a special meaning shall be given to a term if it is established that the parties so intended”.
29 Cited from OECD 2008, p. 117.
30 *Joy Mining Machinery Limited v. Arab Republic of Egypt*. ICSID Case No. ARB/03/11.
31 Ibid., para 81.
If we follow the reasoning of the Tribunal in *Joy mining v. Egypt*, we can conclude that if the breach of a contract by a state is serious enough, it might “trigger the treaty protection” and subsequently create a link between a contract and a treaty. Thus it is the nature of the state conduct that should be the essential factor in the decision of whether an investment treaty Tribunal should adjudicate a contract dispute. This claim already addresses the special role of the State in contract disputes with foreign investors and brings us closer to the “middle approach”. This will be returned to in chapter 3.

Some tribunal decisions imply a substantially wider interpretation of the clause. In *Noble Ventures v. Romania*[^32], the Tribunal concluded that the only meaningful way to give effect to the umbrella clause, and this was necessary because of the principle of effectiveness[^33], was to take the clause as an effective tool to “internationalise” a breach of a contract and thus transform it into a breach of a treaty[^34]. This reasoning suggests that umbrella clause would form a “link” between a contract and a treaty and the link would function as way to effectively internationalise the contract in the event of a dispute. Therefore jurisdiction of the treaty tribunal would triumph over the jurisdiction of the forum agreed in the contract.

### 2.3 Critique of the Inconsistency

Investment treaty arbitration is a peculiar form of dispute settlement. First of all, it is heedless of the explicit and mutual consent of the parties to arbitrate and therefore it has been called arbitration without privity[^35]. Host states give their consent to arbitrate in the investment treaty and no specific agreement between the parties to the dispute is required. Now it appears that investment arbitration is again taking a step forward: It is not only heedless of the specific consent of the parties, but sometimes it may also completely disregard it. This can happen when the forum clauses of the private contracts are overridden in the name of treaty-based investment protection.

[^32]: *Noble Ventures, Inc. v. Romania*. ICSID Case No. ARB/01/11.
[^33]: See note 18.
[^35]: Paulsson 1995. Paulsson refers to a discussion in the 1960s which concerned sellers’ liability. The fall of privity (or citadel, as it was called by Prosser), then, meant that buyers had a right to direct action against upstream sellers that were unknown to them and with whom they had no direct legal relationship.
The treaty tribunals’ inconsistent interpretations of the umbrella clause, and the resulting uncertainty thereof, might be explained by the relatively young age of the international investment law. As the number of tribunal decisions increases, the swinging of the pendulum probably settles. But for now, increase in legal certainty for both investors and host states does not seem very promising. Foreign investment regime, if such even can be said to exist, is not a uniform and predictable system. Moreover, the increase in the number of investment arbitrations is still accompanied by tactical structuring of investments in a way that they allow investors to create claims under multiple investment treaties. This manoeuvring further increases the likelihood of inconsistent decisions.

It is also notable that inconsistent interpretation of umbrella clauses can rarely be explained by the different wordings of the clauses. The inconsistency, then, might be of a more cognitive origin. It has been claimed that the differing decisions in the three famous cases regarding the treatment of contract claims under the investment treaty regime (Vivendi, SGS v. Pakistan and SGS v. Philippines) derive, rather than from different wordings of the clauses, from ideological divides between international judges and arbitrators over addressing a multiplicity of legal sources and procedures. Situations where these ideological choices materialise arise from the possibility given by investment treaties for investors to pursue their rights in direct international arbitration without the general requirement of international law to exhaust local remedies. Therefore treaty tribunals are in a direct horizontal conflict with the forum of the contract.

It is disputable whether an individual entity is empowered with such ability that it can internationalise a contract. Such a view, advocated e.g. in the reasoning of Noble Ventures v. Romania, is open to criticism at least if the Tribunals view would be understood as representing some kind of a doctrinal reading of the umbrella clauses in general. Private corporations do not have a legal personality under international law. Trying to avoid this shortcom-

36 Franck 2005, p. 1546.
39 Douglas 2004, p. 239.
ing, proponents of the so-called theory of internationalization of contracts have looked for ways to enable investors to escape the detriments of national legislation. However, it would be confusing indeed, both theoretically and practically, to think of an investment contract as functioning on a level of municipal laws, and its transformation into public international law in the event of a dispute, the only thing necessary for this to happen being the desire of an investor to do so. Of course nothing prevents parties to the investment treaty from agreeing that investment-related contract disputes are handled in the treaty context. Consent of the parties to the treaty can then have an internationalising effect on contract disputes. But the problem is that the effect and scope of umbrella clauses is so disputed exactly because specific consent of the contracting parties to the treaty is often hard to indicate. Umbrella clauses can even be included in a treaty without pronounced negotiations on their content.

This paper considers that the inconsistency of the tribunal decisions is rooted in the praxis of judging state conduct along sovereign/merchant lines and in the resulting jurisdictional conflict in investment dispute settlement. The jurisdictional conflict is here called a public/private conflict in investment treaty arbitration. The public sphere presents the traditional form of dispute settlement in the public international law in which states are parties to the dispute, either pursuing their own interests or, by diplomatic protection, the interest of their nationals. Conversely, the private sphere deals with horizontal disputes of a commercial character and thus it functions mainly on a level of municipal law. In the public sphere, the instrument is a treaty and in the private sphere, a contract. It must be noted that the clash of these spheres in the investment treaty arbitration is not the first such case. However, it is the clashes of the rights of states vis-à-vis the rights of aliens which have also before blurred the distinction between public and private.

40 Sornarajah 2007. For the historical origins of the idea of internationalisation of contracts, see p. 417–429. The attempts to internationalise a contract and to neutralise the power of the state include e.g. assimilation of the contract to treaties as if they were “quasi-international agreements” or promoting general principles of law, particularly *pacta sunt servanda* as universal principles which can fill the lacunae existing in the immature municipal legal systems of the host-states.

41 This issue will be returned to in the next chapter.
The next chapter will deal with approaches to the public/private conflict which can be seen as representing a kind of middle approach. What they all have in common is that they are stipulating a criterion according to which some, but not all, contract disputes may become an issue of international law. Usually the decisive factor is the nature of state conduct abrogating the contract.

3 The Doctrine of State Responsibility and the Middle Approach to Public/Private Conflict

3.1 State Responsibility of Breaching a Contract With an Alien

A brief exploration of the discussion regarding the development of the doctrine of state responsibility against injuries caused to aliens reveals that the issue discussed here is a part of the discussion that has started already in the 19th century.\textsuperscript{42} Though the issue is not novel, the setting is somewhat different. During the first part of the 20th century, tribunals and scholars were primarily concerned with the grounds for the launch of diplomatic protection, in which states protected the rights of their nationals. We, on the other hand, are today discussing a regime of investment protection in which private investors are the sole possessors of a right to initiate direct investor-state arbitration. This transition from the state-sponsored arbitration to individually initiated one has been crucial for the enforcement of investors’ rights.\textsuperscript{43} It must also be acknowledged that in the doctrine of state responsibility no absolute requirement has been set for the violated alien to be protected by a specific treaty. The doctrine of state responsibility is rooted in customary international law. Another thing that has changed is that, in the investment treaty context, foreign investors are not anymore by rule obligated to exhaust local remedies in case of a violation of their treaty-based rights.

Notwithstanding these remarkable changes, the dispute regarding contractual arrangements between states and investors is in many respects similar to the one that started already in the 19th century: is a breach of a contract with an alien by a state per se a breach of international law? Amerasinghe depicts the discussion at

\textsuperscript{42} On the discussion, see Amerasinghe 2004, p. 123.
\textsuperscript{43} Wälde 2004b, p. 18–19.
the time in a manner quite familiar: “The opinions of the text writers […] could be divided into two schools: those that maintained that a breach of contract by a state was per se a violation of international law and those that required something more than a mere breach of a contract for a violation of international law to take place. The latter school had more support.”44 Amerasinghe’s studies on the standing of the tribunal authorities on the issue revealed that the tribunals agreed with the scholars. There was very clear evidence in support of the opinion that a mere breach of contract did not suffice for international law to take over.45 Thus something else was needed.

When assessing a breach of a contract by a state with an alien as a possible violation of international law it has been a common analytical starting point to focus on the nature of the state’s behaviour that led to the alleged violation. Both the Tribunal practice46 and the scholarly writings have been prone to systematically distinguish state conduct as a sovereign from pure commercial conduct. This tool has been used particularly by the proponents of the so called “middle approach” or “median position” to the question of whether a violation of a contract with an alien by a state can be judged as wrongful by international law. Schwebel argues rightly that a contract between a state and an alien is not an instrument of international law and therefore its breach can not automatically be a violation of international law. However, he continues, if a contract is breached by non-commercial, that is, sovereign conduct of the state, the doctrine of state responsibility may be invoked.47 This view respects a widely acknowledged principle of international law, codified by the international law commission, according to which

“[t]he characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law”.48

44 Amerasinghe 2004, p. 123.
45 Ibid., p. 120.
48 UN 2008. The commentary of the article notes that the article has two elements; “First, an act of a State cannot be characterized as internationally wrongful unless it constitutes a breach of an international obligation, even if it violates a provision of the State’s own law. Secondly and most importantly, a State cannot, by pleading that its conduct conforms to the provisions of its internal law, escape the characterization of that conduct as wrongful by international law.” The quotation is from the commentary of article 3.
It is an important remark that the rules of the doctrine of state responsibility for internationally wrongful acts can not be directly transferred, as such, to an investment treaty regime. This is because investment disputes are concerned with private interests of the investors in a manner that goes beyond (customary) international law.\textsuperscript{49} It is also said that contractual responsibility and international state responsibility are different things and should be distinguished accordingly.\textsuperscript{50} Notwithstanding, the criterion developed by the doctrine of state responsibility is popular in the investment treaty regime as well.

3.2 The Middle Approach in the Investment Treaty Context

Wälde considered the inclusion of umbrella clauses, or \textit{pacta sunt servanda} clause as he preferred, to investment treaties as only clarifying the status of customary international law. He determined that the clauses’ effectiveness was decisively dependent upon the nature of state behaviour constituting the breach of a contract. According to Wälde, a tribunal should, when determining whether it has jurisdiction to solve a contract-based dispute, follow a two step test: first it must be determined whether the state conduct has been of commercial or governmental nature, and second, it must be decided whether the use of governmental powers has been legitimate, general and not discriminatory, or whether the government’s reliance on its powers has elements of abuse.\textsuperscript{51} Thus the umbrella clause extends treaty protection to contract disputes only so far as a government abuses its powers as a sovereign and a regulator. If such powers have been used, the state has the burden of proof to convince the tribunal that the use of powers has been acceptable.\textsuperscript{52} The same logic is respected by saying that “umbrella clause enables a BIT tribunal to exercise jurisdiction over claims concerning such breaches of contract, which are also BIT violations under the clause, and further permits the tribunal to do so notwithstanding an exclusive forum selection clause in the contract”\textsuperscript{53}.

\begin{enumerate}
\item \textsuperscript{49} Douglas 2004, p. 155. “To treat international law as self-sufficient legal order in the sphere of foreign investment is plainly untenable”.
\item \textsuperscript{50} Zolia 2005, p. 13.
\item \textsuperscript{51} Wälde 2004b, p. 23–25.
\item \textsuperscript{52} Ibid., p. 25.
\item \textsuperscript{53} Wong 2006, p. 137.
\end{enumerate}
Something very similar to the criterion presented was used e.g. by the Tribunal in *El Paso v. Argentina*. Fearing that wide interpretation of the umbrella clause would give incentive for opportunistic investors to invoke investment treaty arbitration in whatever commercial dispute, the Tribunal chose not to extend treaty protection to commercial contracts but only to “[…] additional investment protections contractually agreed by the State as a sovereign […]”. The Tribunal chose to “[…] in view of the necessity to distinguish the state as a merchant, especially when it acts through instrumentalities, from the state as a sovereign”.

This reasoning is very different from that of *Noble Ventures v. Romania* in which the umbrella clause was conceived as an effective way to “internationalise a contract”.

In *SGS v. Philippines*, the arbitration Tribunal was faced with a case quite similar to the Tribunal in *SGS v. Pakistan*. Both the claimant and some of the circumstances of the case were the same. The wordings of the umbrella clauses and their placement in the BITs were slightly different, but arguably not enough to make a decisive difference. The Tribunal did not respect the conclusions made in the *SGS v. Pakistan*, on the contrary, it explicitly distanced itself from the Tribunal’s highly restrictive interpretation of the umbrella clause. The Tribunal held that the concern of the *SGS v. Pakistan* Tribunal of internationalising contracts through an umbrella clause was unwarranted and noted that, rather than turning questions of contract law into questions of treaty law, the umbrella clause only addressed the performance of the ascertained obligations. Moreover, it concluded that BIT did not “convert the issue of the extent or content of such obligations into an issue of international law” and therefore the issue fit into the jurisdiction of the Tribunal. In its reasoning, the Tribunal of the *SGS v. Philippines* went beyond the so called middle approach. The case will be further discussed later.

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55 Ibid., para. 82.
56 Ibid.
57 See note 41 and respective text. It must be noted, however, that such detached notions should be treated very carefully. This is because both the circumstances of the case and the investment treaty interpreted are different.
58 *SGS v. Philippines*, para. 119–120, 125.
59 Ibid., para. 126.
60 Ibid., para. 128.
3.3 Some Implications of the Middle Approach

Various metaphors have been used to describe the effect of the umbrella clauses.\(^{61}\) One is to describe it as a means to “elevate” contractual disputes into the realm of public international law.\(^{62}\) This impression could be used both by the critics (positivists, dualists) and advocates (internationalists, monists) of the wide or integrative interpretation of umbrella clauses. From the point of view of the “middle approach” presented in this chapter, this notion of elevation can be seen as somewhat misleading. The claim that an umbrella clause elevates contract disputes into the sphere of public international law seems to imply that without the umbrella clause a contract dispute would not have been an issue of treaty protection in any case. Without the clause it would remain a municipal affair. This implication is unwarranted in view of customary international law on state responsibility alone.\(^{63}\)

If we think of umbrella clauses as merely extending the treaty protection to contractual disputes in a way that protection only covers the abrogation of contracts by abusive sovereign conduct, the practical meaning of umbrella clauses is restricted to the notion that a host state cannot escape its treaty commitments by private agreements and exclusive jurisdictional clauses. If an umbrella clause extends the protection given by the treaty to contractual disputes, it extends the protection to the contractual disputes insofar as the contract violation also constitutes a treaty violation. Such a violation, then, does not get elevated to the level of public international law but it is public international law. “Semantics”, some might sigh, but nevertheless important if we are to accept the arguments of the middle approach.

The extra flavour that umbrella clauses add to the general principles already stated by customary international law is that according to the treaty, investors may usually invoke direct investor-state arbitration and therefore investors do not need to exhaust local remedies. As for breaches of a contract by sovereign acts, umbrella clauses then authorise investors under its protec-

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\(^{61}\) See e.g. Zolia 2005, p. 1.
\(^{62}\) This notion was used also in SGS v. Pakistan.
\(^{63}\) ILC article 3 on state responsibility, see note 50. As already noted, Wälde understood umbrella clauses as clarifying the status of customary international law, Wälde 2004b, p. 21.
tion to invoke international treaty arbitration despite whatever agreements have been made in investment contracts. This view would surely undermine the dualistic understanding of the international law, of which the rule of exhaustion of local remedies is an important part, but only in the softest sense. The autonomic sphere of the individual transactions and freedom of contract in international commerce is left quite intact, since investment treaties would only address the use of powers unavailable for the individuals of the society and, it might be argued, therefore it would not violate the autonomy of the private sphere at all.

The remedy offered by the middle approach to public/private conflict appears elegant and one might be inclined to accept at least its central propositions. However, it would be challenging to develop a clear-cut criterion for judging state conduct along the sovereign/merchant lines. When this is made a threshold question for the tribunal’s jurisdiction, inevitable problems arise.

4 Public/Private Distinction in the Investment Treaty Arbitration

4.1 Sovereigns and Merchants

Two important puzzles have complicated the discussion on the law of foreign investments. First, the status of private investors in public international law, and second, the status of municipal law in the law on foreign investments. The latter is all the more important because host states, or their direct intermediaries, still frequently enter into contractual agreements with foreign investors and take part in simple commercial transactions. As to the first puzzle, it is a credible observation that in many respects it is only a matter of interpretation whether primary investment treaty obligations are owed directly to qualified investors or only to the contracting states. Some court rulings have held that inter-state treaties can create individual rights other than human rights but it might also be arguable that BITs only institutionalize and reinforce the system of diplomatic protection. However, respecting the many abnormalities of the investment treaty regime and the

64 This is stated also by Wong, see note 54 and respective text.
praxis of investment dispute settlement, it has been convincingly argued that investment treaties address and owe their rights directly to investors.  

Douglas has argued for a *hybrid model* of investment treaty arbitration and critiqued the prevalence of ideas of “diplomatic protection” in investment treaty arbitration. The proponents of the diplomatic protection view see the investment dispute as a horizontal conflict between the contracting states of the treaty. As many investment treaties give investors a direct right to act against host states, the setting would imply to Douglas that investors are procedurally “stepping into the shoes of public authorities”. Douglas opposes this view and holds that it is not supported by investment treaties. Conversely, he argues for a “direct model” which sees investors as direct owners of the rights of investment treaties.

By reversing Douglas’ view we can critique another kind of “mutation” as well. The host states too possess a dual role vis-à-vis foreign investors. It might be argued that by embarking on commercial undertakings through contracts, states are stepping into the shoes of private individuals. This brings us to the second puzzle, i.e., the status of municipal law in the law on foreign investments. Thus, by entering into contractual relationships with investors, states are acting as merchants, as if outside the public sphere and self-disarmed from their public powers. These commercial relationships naturally follow the legislation and a forum which respect the consent of the parties to the contract and the rules of private international law. Parties to the contract are free to choose the applicable law for the contract. Investment treaties are only concerned with the minimum level of protection of the investors and do not meddle, at least in principle, with private contracts. Thus, by concluding an investment related contract with each other, the state and the foreign investor would jump from public international law (i.e. treaty protection) to the sphere of private international law.

This jump from one legal system to another could be justified by the fact that it reflects the consent of the parties to the contract in the same manner as the investment treaty reflects the consent of the contracting states. The

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66 See particularly Hoffmann 2007.
parties to the contact are free to choose the applicable law for the contract, and no investment treaty can override the will of the parties. However, regarding the agreed forum for the settlement of investment-related contract disputes, it is questionable whether the contract can effectively deny the access of the violated investor to BIT tribunals. This question is crucial for solving the jurisdictional conflict (here public/private conflict) in investment disputes. Juxtaposing the conflicting forum agreements which are, again, the host-state’s offer in an investment treaty to arbitrate in a treaty tribunal and an investor’s consent in a contract e.g. to litigate in local courts, is fruitful only if we take into account the inherent structural differences in the two agreements. The essential difference is the mutuality of the agreement, or the lack of it.

For now, we have only elaborated the role of the municipal law in investment treaty arbitration. But it might be illuminating to reverse this relationship, and ask what role can be given to public international law in private contracts. Amerasinghe has problematized the mutuality of the contractual relationship between an alien and a state by an example in which (public) international law is made an applicable law of the contract by choice of law. According to him, it would be peculiar to conceive this act as giving a private entity an international legal personality. This personality would make it possible for the private entity to pursue its contractual rights before international courts. Contract provisions can not give a private entity an international legal status. Also, since mutuality is an important element of the contract, the state party should also have the right to be protected by international law. Contractual agreements on applicable law should not create asymmetrical procedural rights. Moreover, Amerasinghe remarks that no better way to conceive this relationship would be to see it as if the alien would, as a party to the contract, be under the diplomatic protection of its home state. Opposing the internationalisation of the contracts in this sense,

68 It is questionable whether investors can waive the protection of the investment treaty and whether this is done automatically by signing a contract with a jurisdictional clause, see Hoffman 2004. Douglas holds that investment treaty arbitration should not be given a hierarchical supremacy, but that a Treaty’s dispute settlement clause should be seen as a pact that reflects the consent of the signing parties just as investment agreements reflect the consent of the investors and host states. Therefore principles of pacta sunt servanda, generalia specialibus non derogant and prior tempore, potior jure should become effective. Douglas 2004, p. 248.

69 Amerasinghe 2004, p. 129.
Amerasinghe states that the choice of international law is possible “without affecting the legal system in which the contract is placed”.\textsuperscript{70}

Why should we think that this “existential leap” from one legal system to another should be possible another way around? It is disputable if we can argue for the existence of a “global investment regime”\textsuperscript{71}, but investment treaties nevertheless form a legal system for international investment protection, an important part of which is the international dispute settlement procedure. Investment treaties create \textit{asymmetrical rights} for investors and respective obligations for host-states, e.g. not to arbitrarily expropriate the investment and to guarantee fair and equitable treatment. An umbrella clause is not different, but it is asymmetrical as well. The conclusion of a contract between the investor and the host-state should not affect this initial legal system set up for the protection of investors’ rights. Or, put somewhat differently but respecting the same logic, a contract should not \textit{domesticate} the treaty-based relationship between the host state and the investor. If the argument is reversed like this, we do not need to feel so troubled by giving the “one-sentenced” umbrella clause such a substantial effect as “elevating” contractual disputes into the sphere of public international law.\textsuperscript{72} Maybe the \textit{raison d’être} of the umbrella clause is that contractual disputes related to investment should never have escaped the sphere of treaty protection in the first place.

As presented above, the middle approach to public/private conflict is inclined to accept investors’ claims before an investment treaty tribunal if the claims are based on abusive sovereign conduct of a state. It is argued here that the obligation set in the umbrella clause to the host-state to observe any obligation it may have entered into with regard to an investment is an international limitation of states’ rights vis-à-vis foreign investors \textit{both as a sovereign and a merchant}. Protection given by the umbrella clause is not mutual but asymmetrical, just as is an investor’s unilateral right to initiate treaty-based arbitration in the case of a violation of its rights. It is the state, and only the state, that has to observe its obligations. The conclusion of the

\textsuperscript{70} Ibid., p. 129–130.
\textsuperscript{71} Salacuse 2007, p. 163.
\textsuperscript{72} See note 26 and respective quotation.
investment-related contract (that creates mutual obligations) with a foreign investor does not make this obligation void. The implications of the umbrella clause should then be that contract provisions, conceived in principle as a closed and autonomic system in relation to public international law, cannot act as a safe haven for sovereigns to escape their commitment to direct investor-state arbitration in which a neutral tribunal decides if the state has failed to perform its promises.

4.2 The Autonomy of the Private Sphere and Freedom of Contract

For classical legal theorists, contract law was the core of the private law and through the functioning of the free will of the self-interested contracting parties the market could function outside state regulation.73 Realists attacked this simplification and tried to show that contract law was not as private as it seemed. Conversely, it was essentially public in nature. Public law meddled in the business of private law, because it was necessary for the balancing of the powers of the contracting parties. Thus, public law had a redistributive character.74 In his classic article “The basis of Contract”, Morris J. Cohen unveiled the social roots of the contract by stipulating that the state had a positive role using its organizing force in enforcing contracts.75 Cohen saw the institution of contract as a means to confer sovereignty on one party over another by putting the forces of the state at the disposal of the latter, that is, of the one whose rights have been violated.76

Since the international system is founded, in Max Weber’s classical terms, by sovereign states in possession of monopoly on the legitimate use of violence in their territories and consequently there are no international “sheriffs and marshals”77 to be given at the disposal of the violated contracting party, the only thing left for foreign investors are the judges. After the rulings of international judges, then, the mechanism of international enforcement (very much a matter of treaty), may be invoked indirectly. As Amerasinghe

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73 Singer 1988, p. 479.
74 Ibid., p. 483.
75 Cohen 1933, p. 585.
76 Ibid., p. 587.
77 According to Cohen’s famous words “The law of the contract, then, through judges, sheriffs and marshals puts the sovereign power of the state at the disposal of one party to be exercised over the other party”, in ibid., p. 586.
emphasizes, enforcement can only take place after judicial decisions have
been made. He sees investment treaty arbitration in contract disputes as a
"special dispute settlement mechanism" which does not necessarily address
international wrongs when it comes to contract-based claims. It is this inves-
tors' right, not only to plea to a neutral tribunal, but a right to indirectly
invoke treaty-based international enforcement of the awards which makes
umbrella clauses a matter of great importance for investors.

When assessing the commercial relationship which has been created by the
contract, a critical notion is the mutuality of the legal relationship between
the state and the investor. Accepting the mutuality of the investor-state
contract, we can see this investor-state relationship through the eyes of Sir
Henry Sumner Maine as forming a part of the progressive movement of the
(international) society “from status to contract”. Through this movement,
the autonomy of the contracting parties becomes the focal point of the
contract. The parties to the contract are autonomous entities entering into
a horizontal relationship of which substantive content is not regulated by a
higher authority. This pure type of autonomy of the private sphere can be
accepted in the foreign investment context as well. Investment treaties do
not attempt to restrict the powers of the host states to negotiate the sub-
stance of the investment-related contracts. Umbrella clauses do not affect
choice of law clauses in the investor-state contracts.

However, in order to guarantee the observance of the states’ obligations
towards investors, and the performance of these obligations, a treaty tribu-
nal must have jurisdiction on contractual disputes as well. To judge state
conduct in this relationship is not to draw lines between commercial/sover-
eign conduct, but to determine the legitimate expectations of the investor.
Asymmetrical provisions of investment treaties are rooted in the different
legal statuses of investors and states. By signing a contract, a State does

78 Amerasinghe 2004, p. 140.
79 Ibid., p. 129. See also previous chapter on the mutuality of the contract and on the
asymmetry of the investment treaty provisions.
80 Maine 1954, p. 100.
81 Schill 2009, p. 24, stating that “[...] While the obligations on the BIT are obligations
entered into under international law, the relations between investor and host-state re-
main governed by whatever law the parties to the investor-State contract have chosen
as the applicable law”.
not become an individual or vice versa. Umbrella clauses are asymmetrical provisions that have permeable effect on private obligations. Therefore, as to host states and foreign investors, a total movement “from status to contract” is an unreachable target.

Judging the nature of state conduct remains, of course, a fundamental part of investment disputes. It is necessary, for instance, in the case where we have to determine the acceptable grounds for the state to abrogate a contract or alter legislation in a way injurious to the investor. Such reasons may be e.g. social or environmental and given the existence of acceptable and legitimate causes for such a “positive” sovereign act and a just compensation for the investor whose economic interests have been violated, a right to perform its sovereign functions as a state might also be a basis for the legitimate abrogation of the contract.

Let us assume that there is a state claiming that the abrogation of the contract resulted from such a “positive sovereign act”. It is, then, the essential condition for making a just decision by the tribunal, to determine whether there was a legitimate basis for such an act or not. In case of an investor alleging the existence of a “negative sovereign act” it should be the essence of the case before the tribunal to determine whether there is a basis for such claims. The investment treaty tribunals are destined to move on the continuum of public and private. We can not totally escape the need to address state conduct along the public/private lines because it is an important part of determining the merits of the case.

4.3 Pacta Sunt Servanda

The taxonomy of states and investors as public or private or possibly even both has been somewhat baffling. One example is the discussion on the principle of *pacta sunt servanda* and its role in investment treaty arbitration. The exploitation of the principle in the argumentation gives a perfect example of how the dual role of states as public/private entities can be used in different patterns of argumentation. First, *pacta sunt servanda* was advocated by the theory of internationalisation of contracts which argued it to be a general principle of law and thus it should be effective in international
agreements as well.82 This analogy to private law could be challenged on the grounds that investment agreements such as concessions are not private in nature, but more akin to administrative contracts and therefore an issue of public law.83 Conversely, when challenging the jurisdiction of the investment treaty tribunal, it is usually claimed that because the entered agreement is embedded in the municipal law of the states (i.e. contract law), an investment treaty tribunal lacks jurisdiction in contract disputes. A forum clause should not be dismissed because treaty tribunals must respect the collective will of the parties and the principle of *pacta sunt servanda*.84

Respecting the logic presented, the following conclusions can be made: Because the contractual relationship between the investor and a host state is vertical in that the other is a public authority and the other a private person, *pacta sunt servanda* cannot be given an effect as a universal legal principle. Only if the investor as a direct owner of treaty rights was seen as using public powers and the agreement (contract) was assimilated to the treaty, *pacta sunt servanda* might again become effective because of the well known rule in the public international law that “*every treaty in force is binding upon the parties to it and must be performed by them in good faith*”85 But as we have seen, the shoes of the public authorities might just be too big for investors. The other conclusion could be made after leaping to the private/municipal sphere of law: Because a contract is a matter of municipal law, and relations between the host state (acting as a merchant) and the investor are a purely private and horizontal matter, a treaty tribunal lacks jurisdiction. The consent of the parties to the contract must be respected and therefore the jurisdiction of the forum appointed in the contract would triumph.86

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82 See Sornarajah 2007, p. 421. In the investment treaty context perhaps the best example of such effort is found in Wälde 2004b, p. 27. Though Wälde emphasized the meaning of the pacta sunt servanda principle, he did not give unconditional support for internationalisation, but advocated a criterion which is in this paper called a middle approach.

83 Sornarajah, 2007, p. 422–423. Sornarajah states that “the theory of internationalisation which is contract-centered may be a casualty in these developments”.


86 See Douglas 2004, p. 283. Douglas holds that this argument is mandated e.g. by the principles of *pacta sunt servanda*, and *generalia specialibus non derogant*, which also presuppose horizontality. Douglas, however, also requires that the causa of the claim originates from the breach of a contract and not a breach of a treaty.
Thus it might be read into the statements presented in this chapter that whether the principle of *pacta sunt servanda* can be applied depends on the *nature of the agreement* entered into by the state and a foreign investor. Is this not only another way to repeat and manipulate the public/private distinctions already drawn in assessing the statuses of states and investors as public/private entities or sovereign/merchant nature of a state’s conduct? Duncan Kennedy’s remark on such manipulation of the boundaries of public and private is worth repeating here: “[…W]e have no meta principle of appropriateness that will tell us when argument *A* is right or when, on the contrary, it is flat wrong and *B* is right. When a distinction reaches this stage, using it in legal argument seems a mere exercise: we can do it so well we can’t believe it anymore.”

5 Some Practical Implications

What are the practical implications, then, of the (very theoretical) arguments presented in this paper? Of course we can not deprive a state of its full legal competence to enter into contracts with foreign investors. By stating that contractual disputes related to the investment should not leave the sphere of treaty protection is only to say that the concluded contract can not make treaty provisions on investment protection void. However, an investment treaty does not make a contract void either. Respective obligations agreed by the contracting parties and the law regulating their fulfilment still hold and it is the duty of a tribunal settling the dispute to respect these agreements. It is the *performance of the host state*, which is under the scrutiny of the tribunal, not the equity of the contract’s substance. Performance of promises is important because the investor and the operation of the investment might be inescapably dependent on them.

Should it be possible, then, to hand every dispute arising from a breach of a contract by a state to international tribunals? The result might be a notorious “flood” of cases. Some authors optimistically rely on rational self-restraint of

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88 E.g. a contractual promise to provide for the investor the necessary energy or materials for running the investment related business. Non-performance of these promises may prove fatal for the investment.
the investors. The cases before investment treaty tribunal might also consider only partially, if at all, the problems falling under the provisions of the investment treaty. Thus the tribunal might find itself adjudicating a dispute of a commercial character, primarily according to the municipal law applicable to the contract. In these situations, a tribunal might feel tempted to hand the jurisdiction for deciding the specific content of the failed obligations (e.g. the amount of money owed) to a more proper forum. This would again lead to jurisdictional uncertainty and duplication of proceedings. As the Tribunal in *SGS v. Philippines* remarked:

"[…] the purpose of the BIT is to promote and protect foreign investments. Allowing investors a choice of forum for resolution of investment disputes of whatever character is consistent with this aim. By contrast drawing technical distinctions between causes of action arising under the BIT and those arising under the investment agreement is capable of giving rise to overlapping proceedings and jurisdictional uncertainty. It may be necessary to draw such distinctions in some cases, but it should be avoided to the extent possible, in the interests of the efficient resolution of investment disputes by the single chosen forum."

However, while making this remark, the Tribunal assigned parts of the case (simple contractual obligations) to municipal courts of the host state. What is important, however, is that the Tribunal retained its jurisdiction on certain aspects of the case though it stayed the proceedings for the time the municipal courts of the Philippines had decided the case. Manoeuvring via treaty tribunal, then, in the case of *SGS v. Philippines* did not allow the investor to escape domestic proceedings. However, from the point of view of the investor, this manoeuvre might prove necessary at least because of three reasons. First, it still got the protective umbrella of the treaty for its use, i.e. there is an international authority watching over the performance of the host state’s promises even though the specific content of the promises is decided by the domestic courts. Secondly, it is not obligatory to exhaust local remedies before returning to the treaty tribunal, but if a satisfying and
just ruling is achieved in the first instance, and the respondent (host state) settles on the decision as well, the proceedings in the international tribunal could continue. Third, manoeuvring via treaty tribunal might be necessary also because of the possible fork in the road clauses included in many Investment treaties.\footnote{A typical fork in the road clause in the investment treaty provides that the investor is made to choose between the domestic courts and international arbitration to litigate its claims, and that choice, after it has been made, is final. See Schreuer 2004, p. 239.}

The treaty tribunal is free to exercise its authority also by invoking the forum non conveniens, for instance, in refusing a simple commercial dispute which has no significant effect on the investor’s undertaking. But a tribunal is not obligated to do so. Contract clauses should not deprive the tribunal of its jurisdiction in investment-related disputes. If the tribunal is pleaded to in a commercial dispute crucial for the investment, the forum clause should not result in automatic lack of jurisdiction. We do not need only to trust on the discretion of the investors not to bring every minor dispute to (costly) international tribunals and flooding them with cases not belonging there. We should also trust on the discretion of the tribunal to reject the case, or steer parts of it to another court, if it thinks there is another forum more appropriate. This does not mean that the tribunal should reject every case of a commercial character. As regard to fearing the opening of the floodgates, the double discretion of both the investors and the tribunals should efficiently prevent the flooding of international tribunals with minor commercial disputes.

6 Concluding Remarks

The development of sound rules for interpretation of investment treaty provisions capable of affecting private agreements has been somewhat absent. It might just be that international judges, as scholars and politicians, are meddling in a discourse quite ideological in nature.\footnote{Shany 2005, p. 844.} It would be a difficult task to develop a legitimate and formal criterion for distinguishing state conduct as sovereign or merchant. In the investment treaties this would be plainly impossible and through the decisions of treaty tribunals difficult, particularly because no important effect can be given \textit{de jure} to the precedents.
If investor-state contracts would totally evade the different legal statuses of the investors and states, investment treaty arbitration could be ignored by exclusive jurisdiction clause. If we only accept this notion as far as a state does not abuse its public powers, as suggested by the middle approach\(^93\), a proper legal system for contract related investor-state disputes would be dependent upon which role the state has been playing while signing the contract and/or violating it: a merchant or a sovereign.

Categorizing state conduct according to the arbitrary rubrics of “commercial” or “sovereign” represents a mirror image of public/private distinction of law constituted in classical legal thought. The source of jurisdictional conflicts in investment treaty arbitration is the subjective conception of the state as an institution performing multiple roles in society and thus moving on the public-private continuum. If we are to accept the middle approach to the public-private conflict, we will engage us to the endless development of the criterion for choosing of which end of the continuum the state was closer to when it signed and/or allegedly violated the contract.\(^94\) We should not disregard the different legal statuses of the states and investors. If we keep the state as a state and a private investor as private legal person in investment disputes we do not need to make either of the parties to perform existential leaps between international and municipal legal systems. Investment treaty arbitration is located neither in the public international nor municipal system of law. Amerasinghes’ insight on this problem is helpful: What is created is an extra-national special dispute settlement mechanism in which a contract dispute turns into a matter of public international law only when we turn into the enforcement of the awards\(^95\).

\(^93\) See chapter 3.2.  
\(^94\) Kennedy has depicted eloquently the lengthy process of the decline of public/private distinction. The decline of the distinction results mainly from the difficulties in developing clear and objective rules or criteria for judging an institution as public or private. See Kennedy 2004.  
\(^95\) Amerasinghe 2004, p. 80. See also p. 127 “What the states parties to the jurisdictional treaty did as to confer jurisdiction and give the alien a locus standi before an international tribunal […] but not at an international level adjudicated upon by an international tribunal.” Moreover he states that “[t]he jurisdictional treaty does not have any impact on the substantive relationship between the parties to the contract”. It must be further noted that the credibility of the investment regime itself could be questioned because of the weak enforcement of the tribunal awards. On the legitimacy and problems of international investment law particularly in Latin-America, see Ryan 2008.
The practical claims of this paper are the following: Judging the nature of state conduct along sovereign/merchant lines cannot and should not be neglected because it is important in deciding the merits of a case. However, it should not be made a threshold question for appointing a proper legal system for the dispute. By doing so, we are turning a question that is crucial for adjudicating a case in a just way into a procedural dilemma of settling the conflict of jurisdictions. Investment treaties have set up a legal system for investment disputes and investors protected by umbrella clauses should have the right to plea to a neutral treaty tribunal. However, this is not an absolute right. A treaty tribunal should be able to assign the case or parts of it to another court/tribunal if it feels that it is more suited to adjudicate the substantive obligations of the violated contract. By doing this, the treaty tribunal is not obligated to dismiss itself from the case completely, but it can stay its proceedings for the time the municipal court has decided its case. This was the conclusion of the Tribunal in *SGS v. Philippines*. 
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