



## 10. Investment Treaty Arbitration and Jurisdiction Over Contract Claims – the SGS Cases Considered

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Rarely have practitioners and legal commentators expected a decision on jurisdiction, in the context of investment treaty arbitration, with as much eagerness as the decision of August 27, 2003 in *SGS v. Pakistan*.<sup>1</sup> One of the key issues in *SGS v. Pakistan*, that of the effect of the so-called “umbrella” clause<sup>2</sup> or, more plainly, the “observance of undertakings” clause,<sup>3</sup> was first discussed in the 1960s by authorities such as Professor

\* The author acted as counsel for the Claimant in *SGS v. Pakistan* (later settled by the parties on an amicable basis) as well as in *SGS v. Philippines*. The views expressed here have been made exclusively in the author’s personal capacity.

<sup>1</sup> *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13) [hereinafter “*SGS v. Pakistan*”], Decision of August 6, 2003, 18 ICSID Rev. 307 (2003); 42 ILM 1290 (2003); for a French translation and commentary, see Emmanuel Gaillard, *La jurisprudence du CIRDI* (Pedone, 2004), at 815 *et seq.* The decision in *SGS v. Pakistan*, as well as the decision on jurisdiction rendered shortly afterwards in *SGS v. Philippines*, have been discussed in the following articles: Stanimir A. Alexandrov, *Introductory Note to International Centre for the Settlement of Investment Disputes (ICSID): SGS Société Générale de Surveillance S.A. v. Pakistan*, 42 ILM 1285 (2003); *Breaches of Contract and Breaches of Treaty. The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, 5 J. World Inv. & Trade 555 (Aug. 2004); Christoph Schreuer, *Traveling the BIT Route. Of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 J. World Inv. & Trade 231 (Apr. 2004); Thomas W. Wälde, *The ‘Umbrella’ (or Sanctity of Contract/Pacta Sunt Servanda) Clause in Investment Arbitration: A comment on Original Intentions and Recent Cases*, forthcoming, 21 Arb. Int’l (2005); Ole Spiermann, *Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties*, 20 Arb. Int’l 179 (2004), at 194 *et seq.*

<sup>2</sup> On the history of umbrella clauses, see Anthony C. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, forthcoming, 20 ARB. INT’L 411 (2004). In addition to the writings referred to *supra* note 1, umbrella clauses have been discussed in the following recent articles: Bernardo M. Cremades and David J. A. Cairns, *Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes*, in *Arbitrating Foreign Investment Disputes. Procedural and Substantive Legal Aspects* 325 (Norbert Horn ed., Kluwer 2004); Thomas Wälde, *Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience*, in *Arbitrating Foreign Investment Disputes. Procedural and Substantive Legal Aspects* 193, at 214 *et seq.*, *supra*.

<sup>3</sup> On questions of terminology, see the *SGS v. Pakistan* decision, *supra* note 1, at paras. 98-99 and 163. The author has also suggested the concept of the “mirror effect” clause, reflecting the notion that a contractual breach is mirrored in the international legal order as a violation of the investment protection treaty, see Emmanuel Gaillard, *La jurisprudence du CIRDI*, *supra* note 1, at 759; Emmanuel Gaillard, *L’arbitrage sur le fondement des traités de protection des investissements*, 2003 Rev. arb. 853, at 868. For different terminology referring to “*pacta sunt servanda*” clauses, see Thomas W. Wälde, *The ‘Umbrella’ (or Sanctity of Contract/Pacta Sunt Servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases*, *supra* note 1.



Weil<sup>4</sup> and Sir Elihu Lauterpacht,<sup>5</sup> but only put to the test in arbitral case law in 2003 before the Arbitral Tribunal constituted in *SGS v. Pakistan*, which was composed of Florentino Feliciano, President, André Faurès and Christopher Thomas.

The dispute in *SGS v. Pakistan* emerged from the PSI entered into between the Swiss company SGS and the Republic of Pakistan whereby SGS was to provide PSI services with respect to goods exported from certain countries to Pakistan. The PSI Agreement was mutually performed, although the parties disputed the adequacy of each other's performance, before Pakistan terminated the Agreement. The resulting dispute between the parties as regards the validity and consequences of the termination gave rise to different proceedings.

In September 2000, Pakistan initiated an arbitration in Pakistan on the basis of the arbitration clause inserted in the PSI Agreement (the "PSI Agreement arbitration"). SGS filed preliminary objections to the jurisdiction of the arbitrator along with a counter-claim for alleged breaches of the PSI Agreement. In parallel, SGS sought the resolution of its disputes with Pakistan under the BIT between the Swiss Confederation and the Islamic Republic of Pakistan and, on October

<sup>4</sup> See Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, in *Collected Courses of The Hague Academy of International Law*, Vol. 128, Year 1961, Part I, at 95, 130 (1961): "il n'y a, en effet, pas de difficulté particulière [en ce qui concerne la mise en jeu de la responsabilité contractuelle de l'Etat] lorsqu'il existe entre l'Etat contractant et l'Etat national du cocontractant un traité 'de couverture' qui fait de l'obligation d'exécuter le contrat une obligation internationale à la charge de l'Etat contractant envers l'Etat national du cocontractant. L'intervention du traité de couverture transforme les obligations contractuelles en obligations internationales et assure ainsi, comme on l'a dit, l'intangibilité du contrat sous peine de violer le traité' ; toute inexécution du contrat, serait-elle même régulière au regard du droit interne de l'Etat contractant, engage dès lors la responsabilité internationale de ce dernier envers l'Etat national du cocontractant." Professor Weil in particular referred to the 1962 OECD Draft Convention on the Protection of Foreign Property which, as revised in 1967, provided in its article 2 that "Each Party shall at all times ensure the observance of undertakings given by it in relation to property of nationals of any other Party." See also Ibrahim Shihata, *Applicable Law in International Arbitration: Specific Aspects in the Case of the Involvement of State Parties*, in *The World Bank in a Changing World* 595 (1995), at 601 ("as Prosper Weil has observed, treaties may furthermore elevate contractual undertakings into international law obligations, by stipulating that breach by one State of a contract with a private party from the other State will also constitute a breach of the treaty between the two States. In many of the newer investment treaties, this approach is followed in provisions giving guarantees in respect of the 'observance of undertakings'").

<sup>5</sup> See Anthony C. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, *supra* note 2.



12, 2001, initiated an ICSID arbitration on the basis of Pakistan's offer of arbitration contained in that Treaty. Proceedings in Pakistan continued, with SGS maintaining its objection to the jurisdiction of the PSI Agreement arbitrator, and Pakistan seeking an injunction from the Pakistani courts to restrain SGS from pursuing the ICSID arbitration. The Supreme Court of Pakistan dismissed SGS's appeal against the decisions rendered by the Senior Civil Judge of Islamabad and by the Lahore High Court directing the parties to appoint arbitrators, granted Pakistan's request to proceed with the PSI Agreement arbitration, and ordered SGS to refrain from pursuing or participating in the ICSID arbitration.<sup>6</sup> The ICSID Tribunal addressed Pakistan's attempt to resort to its own courts to oppose ICSID arbitration in its Procedural Order No. 2 on provisional measures. It recommended that Pakistan not take any step to initiate a complaint for contempt on the basis of the breach of the anti-suit injunction and ensure that any contempt proceedings not be acted upon, and that the PSI Agreement arbitration be stayed until a final decision on the ICSID Tribunal's jurisdiction.<sup>7</sup>

In the ICSID arbitration, SGS argued that Pakistan had violated its treaty obligations, in particular its obligations to promote and protect its investments in Pakistan (articles 3(1) and 4(1)), to ensure fair and equitable treatment of its investments (article 4(2)), to refrain from taking measures of expropriation or measures having the same nature and effect without providing effective and adequate compensation (article 6(1)), and to constantly guarantee the observance of the commitments Pakistan had entered into, namely its contractual commitments (article 11).<sup>8</sup> Pakistan challenged the Tribunal's jurisdiction on a number of grounds that are now routinely raised in the context of treaty arbitration when the claim is based on an IPT and the disputing parties have also entered into a contract concerning the investment. Those grounds included objections relating to the contractual nature of the claims submitted to the Tribunal, while SGS argued that Pakistan's acts and omissions qualified as breaches of the PSI Agreement as well as violations of the BIT.

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<sup>6</sup> See Supreme Court of Pakistan, Decision of July 3, 2002, 19 Arb. Int'l 182 (2003), with an introductory note by Martin Lau at 179; XXVIII Y.B. Com. Arb. 1312 (2003).

<sup>7</sup> *SGS v. Pakistan*, Procedural Order No. 2 on provisional measures, published in 18 ICSID Rev. 293 (2003), at 305.

<sup>8</sup> See the summary of the proceedings in the *SGS v. Pakistan* decision, *supra* note 1, at paras. 30 *et seq.*



The ICSID Tribunal determined that the disputes between the parties emerged from a relationship defined initially by contract,<sup>9</sup> whereas it was constituted on the basis of the BIT. The Tribunal defined the central issue as being whether it had jurisdiction “to determine SGS’s claims which are grounded on alleged violations by Pakistan of certain provisions of the BIT (“the Claimant’s BIT claims”), or its claims grounded on alleged breaches of certain provisions of the PSI Agreement (“the Claimant’s contract claims”), or on both types of claims.”<sup>10</sup>

The distinction based on the cause of action and the relationship between the dispute resolution clauses contained respectively within the BIT and in the underlying investment agreement is now well-recognised in investment treaty arbitration. This distinction found emphasis in *Lanco v. Argentina*,<sup>11</sup> *Salini v. Morocco*,<sup>12</sup> as well as in the annulment decision rendered in *Vivendi v. Argentina*<sup>13</sup> and, later on, in the decision on jurisdiction in *Azurix v. Argentina*.<sup>14</sup> The authority resulting from these cases, although on the basis of somewhat diverging rationales,<sup>15</sup> is that the investor has a right to seek the international responsibility of the host State on the basis of the applicable investment treaty notwithstanding

<sup>9</sup> *SGS v. Pakistan*, *supra* note 1, paras. 10 *et seq.*

<sup>10</sup> *Id.*, para. 146.

<sup>11</sup> *Lanco International, Inc. v. Argentine Republic* (ICSID Case No. ARB/97/6) [hereinafter “*Lanco v. Argentina*”], Decision of December 8, 1998, 40 ILM 457 (2001).

<sup>12</sup> *Salini Costruttori S.p.A. & Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4) [hereinafter “*Salini v. Morocco*”], Decision on jurisdiction of July 16, 2001, 42 ILM 606 (2003), with an introductory note by Emmanuel Gaillard and Yas Banifatemi.

<sup>13</sup> *Compañía de Aguas del Aconquija, S.A. et Compagnie Générale des Eaux (Vivendi Universal) v. Argentine Republic* (ICSID Case No. ARB/97/3) [hereinafter “*Vivendi v. Argentina*”], Award of November 21, 2000, 40 ILM 426 (2001); 16 ICSID Rev. 643 (2001); Decision of the *ad hoc* Committee of July 3, 2002, 41 ILM 1135 (2002); 6 ICSID Rep. 340 (2004).

<sup>14</sup> *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12) [hereinafter “*Azurix v. Argentina*”], Decision on jurisdiction of December 8, 2003, 43 ILM 259 (2004), with an introductory note by Emmanuel Gaillard.

<sup>15</sup> The Tribunals in *Lanco v. Argentina* and *Salini v. Morocco* decided that the contractual choice of forum clause in favor of the local administrative courts could not be opted for by the parties and therefore did not constitute an “applicable, previously agreed dispute settlement procedure” under the applicable BIT. Adopting a different approach, the *ad hoc* Committee in *Vivendi* and the Tribunal in *Azurix* placed the focus on the norms that were allegedly violated, namely the contractual provisions on the one hand and the treaty provisions on the other, and on the corollary distinction between contractual liability and a State’s international responsibility. Under the *Vivendi-Azurix* approach, the rights asserted under a contract and those asserted under a treaty are different in nature and, accordingly, the undertakings by the parties with respect to the contract are distinct from those relating to the treaty. See Emmanuel Gaillard, introductory note to *Azurix v. Argentina*, *supra* note 14.

the forum selection clause contained in the investment agreement. The same reasoning was adopted by the Tribunal in *SGS v. Pakistan*:

147. As a matter of general principle, the same set of facts can give rise to different claims grounded on differing legal orders: the municipal and the international legal orders....

148. BIT claims and contract claims appear reasonably distinct in principle. Complexities, however, arise on the ground, as it were, particularly where, as in the present case, each party claims that one tribunal (this Tribunal or the PSI Agreement arbitrator) has jurisdiction over both types of claims which are alleged to co-exist. In the *Vivendi Annulment* decision, the Annulment Committee went on to say that: “98. In a case where the *essential basis of a claim* brought before an international tribunal is a *breach of contract, the tribunal will give effect any valid choice of forum clause in the contract....* 101. On the other hand, where the *fundamental basis of the claim is a treaty laying down an independent standard* by which the conduct of the parties is to be judged, *the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state ... cannot operate as a bar to the application of the treaty standard. At most, it might be relevant—as municipal law will often be relevant—in assessing whether there has been a breach of the treaty.* (Emphasis added).”<sup>16</sup>

As a result, the Tribunal determined that it had jurisdiction over SGS’s claims arising under the BIT:

We conclude that the Tribunal has jurisdiction to pass upon and determine the claims of violation of provisions of the Swiss-Pakistan BIT raised by the Claimant. We do not consider that that jurisdiction would to any degree be shared by the PSI Agreement arbitrator.<sup>17</sup>

This solution is now well established in investment treaty arbitration. The novelty of the issues before the *SGS v.*

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<sup>16</sup> *SGS v. Pakistan*, *supra* note 1, paras. 147-148.

<sup>17</sup> *Id.*, para. 155.



*Pakistan* Tribunal, however, related to the Tribunal's jurisdiction over claims arising *solely* out of the PSI Agreement. In this respect, the Tribunal discussed in turn the BIT's dispute resolution clause (Article 9) and the observance of undertakings clause (Article 11).

After considering each of these provisions, the *SGS v. Pakistan* Tribunal declined jurisdiction over those of SGS's claims which the Tribunal characterised as arising solely out of the PSI Agreement. Shortly thereafter, the Tribunal's reasoning and decision were discussed at length by the Arbitral Tribunal constituted in another ICSID case between SGS and the Republic of Philippines and composed of Ahmed El-Kosheri, President, Antonio Crivellaro and James Crawford.<sup>18</sup> Much of the analysis of the *SGS v. Philippines* Tribunal refers to, and contradicts the conclusions of the *SGS v. Pakistan* Tribunal with respect to the jurisdiction of arbitrators appointed on the basis of an investment treaty over contractual claims. Both decisions must therefore be examined together, as they each address the jurisdiction of a tribunal constituted on the basis of an investment treaty over contractual claims where the investment treaty contains an observance of undertakings clause (II) as well as in the absence of such a clause (I).

**A. A BIT Tribunal's jurisdiction over contractual claims in the absence of an observance of undertakings clause**

The Tribunal in *SGS v. Pakistan* was required to determine whether it had jurisdiction over SGS's claims that Pakistan had breached the PSI Agreement on the basis of the forum selection clause contained in the BIT, *i.e.* Article 9 of the BIT, which provides that:

(1) For the purpose of solving disputes with respect to investments between a Contracting Party and an investor of the other Contracting Party and without prejudice to Article 10 of this Agreement (Disputes between Contracting Parties), consultations will take place between the parties concerned.

(2) If these consultations do not result in a solution within twelve months and if the investor concerned gives a

<sup>18</sup> *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (ICSID Case No. ARB/02/6) [hereinafter "*SGS v. Philippines*"], Decision on jurisdiction of January 29, 2004, 19 Mealey's: Int'l Arb. Rep. C1 (Feb. 2004). See the commentaries *supra* note 1.



written consent, the dispute shall be submitted to the arbitration of the International Centre for Settlement of Investment Disputes, instituted by the Convention of Washington of March 18, 1965, for the settlement of disputes regarding investments between States and nationals of other States.<sup>19</sup>

To the extent that Article 9 refers to “disputes with respect to investments,” such a broad phrasing may arguably provide sufficient basis for a BIT tribunal to decide any disputes with respect to investments, including disputes arising solely out of an investment contract rather than disputes alleging violations of the obligations contained in a BIT. The wording “with respect to” investments may indeed be contrasted with that of other BIT dispute resolution provisions relating to State-to-State disputes which cover disputes “concerning the interpretation or application” of the treaty. It may also be contrasted with investor-to-State dispute resolution provisions in other BITs which limit the scope of the arbitration to disputes “concerning an obligation of the [host State] under this Agreement.”<sup>20</sup>

The question of a BIT tribunal’s jurisdiction over contractual claims on the sole basis of a broadly drafted BIT dispute resolution clause remains unsettled in ICSID case law. A first approach, adopted in *Salini v. Morocco*, *Vivendi v. Argentina*, and subsequently in *SGS v. Philippines*, consists of giving effect to the broad language of the dispute resolution clause. Under a second approach, espoused by the Tribunal in *SGS v. Pakistan*, the broad wording of the dispute resolution clause found in the BIT is not sufficient justification for the jurisdiction of the BIT tribunal over purely contractual claims.

In *Salini v. Morocco*, the dispute resolution clause contained at Article 8 of the applicable BIT offered the investor the option of choosing one of

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<sup>19</sup> Article 11 of the PSI Agreement provided for its part that: “Any dispute, controversy or claim arising out of, or relating to this Agreement, or breach, termination or invalidity thereof, shall as far as it is possible, be settled amicably. Failing such amicable settlement, any such dispute shall be settled by arbitration in accordance with the Arbitration Act of the Territory as presently in force. The place of arbitration shall be Islamabad, Pakistan and the language to be used in the arbitration proceedings shall be the English language.”

<sup>20</sup> See, e.g., the alternative version of Article 8(1) of the United Kingdom Model BIT, in UNCTAD, *International Investment Instruments: A compendium* (1996), Volume III, Document No. 69, available on [www.unctad.org](http://www.unctad.org). See also Article XII(1) of the 1998 Canada-Costa Rica BIT, quoted by Stanimir Alexandrov, *Breaches of Contract and Breaches of Treaty. The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, *supra* note 1, at footnote 106.



the three dispute resolution fora with respect to “[a]ll disputes or differences ... between a Contracting Party and an investor of the other Contracting Party concerning an investment ....” The Tribunal held that the terms of that provision were “very general,” and that the “reference to expropriation and nationalisation measures, which are matters coming under the unilateral will of a State, cannot be interpreted to exclude a claim based in contract from the scope of application of this Article.”<sup>21</sup> The only exclusion covered “breaches of a contract to which an entity other than the State is a named party,”<sup>22</sup> which is an exception *ratione personae* rather than *ratione materiae*. Under this approach, the substantive protection accorded by the host State to the investors of the other contracting Party to the BIT fully extends to choice of forum and to the correlated right accorded to those investors to bring their disputes before an international—and neutral—forum.

A similar line of reasoning was adopted by the *ad hoc* Committee constituted in *Vivendi v. Argentina*, although this was in the context of the fork in the road clause contained in the applicable BIT. In that case, the dispute resolution clause also offered a choice of forum for the resolution of disputes “relating to investments made under th[e] Agreement between one Contracting Party and an investor of the other Contracting Party.” The *ad hoc* Committee held that:

[this provision] does not use a narrower formulation, requiring that the investor’s claim allege a breach of the BIT itself. *Read literally, the requirements for arbitral jurisdiction in Article 8 do not necessitate that the Claimant allege a breach of the BIT itself: it is sufficient that the dispute relate to an investment made under the BIT.* This may be contrasted, for example, with Article 11 of the BIT, which refers to disputes “concerning the interpretation or application of this Agreement”, or with Article 1116 of the NAFTA, which provides that an investor may submit to arbitration under Chapter 11 “a claim that another Party has breached an obligation under” specified provisions of that Chapter.<sup>23</sup>

In the same vein, the Tribunal constituted in *SGS v. Philippines* decided to give effect to the broadly drafted dispute resolution provision of the

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<sup>21</sup> *Salini v. Morocco*, *supra* note 12, para. 59.

<sup>22</sup> *Id.*, para. 60.

<sup>23</sup> *Vivendi v. Argentina*, *supra* note 13, para. 55 (citations omitted) (Emphasis added).



Swiss-Philippines BIT, which provided for ICSID arbitration as regards “disputes with respect to investments” between an investor and the host State:

134. The present Tribunal agrees with the concern that the general provisions of BITs should not, unless clearly expressed to do so, override specific and exclusive dispute settlement arrangements made in the investment contract itself. On the view put forward by SGS it will have become impossible for investors validly to agree to an exclusive jurisdiction clause in their contracts; they will always have the hidden capacity to bring contractual claims to BIT arbitration, even in breach of the contract, and it is hard to believe that this result was contemplated by States in concluding generic investment protection agreements. But there are two different questions here: the interpretation of the general phrase “disputes with respect to investments” in BITs, and the impact on the jurisdiction of BIT tribunals over contract claims (or, more precisely, the admissibility of those claims) when there is an exclusive jurisdiction clause in the contract. It is not plausible to suggest that general language in BITs dealing with all investment disputes should be limited because in some investment contracts the parties stipulate exclusively for different dispute settlement arrangements. As will be seen, it is possible for BIT tribunals to give effect to the parties’ contracts while respecting the general language of BIT dispute settlement provisions.

135. Interpreting the text of Article VIII in its context and in the light of its object and purpose, the Tribunal accordingly concludes that in principle (and apart from the exclusive jurisdiction clause in the CISS Agreement) it was open to SGS to refer the present dispute, as a contractual dispute, to ICSID arbitration under Article VIII(2) of the BIT.<sup>24</sup>

The *SGS v. Philippines* Tribunal found that the general wording of the BIT dispute settlement provision warranted a purely contractual claim

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<sup>24</sup> *SGS v. Philippines*, *supra* note 18, paras. 134-135.



to be submitted to a tribunal constituted on the basis of the BIT. The Tribunal, however, drew no consequences from this conclusion, as it decided to stay the ICSID proceedings and referred the parties to the contractual dispute resolution mechanism:

155. To summarize, in the Tribunal's view its jurisdiction is defined by reference to the BIT and the ICSID Convention. But the Tribunal should not exercise its jurisdiction over a contractual claim when the parties have already agreed on how such a claim is to be resolved, and have done so exclusively. SGS should not be able to approbate and reprobate in respect of the same contract: if it claims under the contract, it should comply with the contract in respect of the very matter which is the foundation of its claim. The Philippine courts are available to hear SGS's contract claim. Until the question of the scope or extent of the Respondent's obligation to pay is clarified... a decision by this Tribunal on SGS's claim to payment would be premature.<sup>25</sup>

The Tribunal's attempt "to give effect to the parties' contracts while respecting the general language of BIT dispute settlement provisions,"<sup>26</sup> results in practice in an impossible situation to the extent that it attempts to render compatible two contradictory intentions: the parties to the investment contract seek an exclusive forum, whereas the intention of the contracting Parties to the BIT is to accord to the investors a choice of forum. Furthermore, to the extent this solution recognises, "in principle," an investor's right to choose an international arbitral tribunal for the settlement of its investment disputes and, in the same breath, requires that the selected tribunal stay the proceedings on the basis of an exclusive forum selection clause contained in the investment contract, it results in the BIT tribunal having jurisdiction over an empty shell and depriving the BIT dispute resolution provision of any meaning. As such, the *SGS v. Philippines* decision is hardly satisfactory.<sup>27</sup>

A more openly restrictive approach was embraced by the Arbitral Tribunal in *SGS v. Pakistan*, which decided that a broad dispute resolution

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<sup>25</sup> *Id.*, at 155.

<sup>26</sup> *Id.*, at 134.

<sup>27</sup> On this issue, see also Stanimir A. Alexandrov, *Breaches of Contract and Breaches of Treaty. The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, *supra* note 1, at 575, footnote 119.



clause in a BIT is not sufficient basis for a BIT tribunal to have jurisdiction over purely contractual claims:

161. We recognize that disputes arising from claims grounded on alleged violation of the BIT, and disputes arising from claims based wholly on supposed violations of the PSI Agreement, can both be described as “disputes with respect to investments,” the phrase used in Article 9 of the BIT. That phrase, however, while descriptive of the *factual subject matter* of the disputes, does not relate to the *legal basis* of the claims, or the *cause of action* asserted in the claims. In other words, from that description alone, without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in Article 9. Neither, accordingly, does an implication arise that the Article 9 dispute settlement mechanism would supersede and set at naught all otherwise valid non-ICSID forum selection clauses in all earlier agreements between Swiss investors and the Respondent. Thus, we do not see anything in Article 9 or in any other provision of the BIT that can be read as vesting this Tribunal with jurisdiction over claims resting *ex hypothesi* exclusively on contract. Both Claimant and Respondent have already submitted their respective claims sounding solely on the PSI Agreement to the PSI Agreement arbitrator. We recognize that the Claimant did so in a qualified manner and questioned the jurisdiction of the PSI Agreement arbitrator, albeit on grounds which do not appear to relate to the issue we here address. We believe that Article 11.1 of the PSI Agreement is a valid forum selection clause *so far as concerns the Claimant’s contract claims which do not also amount to BIT claims*, and it is a clause that this Tribunal should respect. We are not suggesting that the parties cannot, by special agreement, lodge in this Tribunal jurisdiction to pass upon and decide claims sounding solely in the contract. Obviously the parties can. But we do not believe that they have done so in this case. And should the parties opt to do that, our jurisdiction over such contract claims will rest on the special agreement, not on the BIT.



162. We conclude that the Tribunal has no jurisdiction with respect to claims submitted by SGS and based on alleged breaches of the PSI Agreement which do not also constitute or amount to breaches of the substantive standards of the BIT.<sup>28</sup>

In the *SGS v. Pakistan* Tribunal's view, the phrase "disputes with respect to investments" contained in Article 9 of the BIT could not, in and of itself, provide a basis for the Tribunal's jurisdiction over purely contractual claims. The Tribunal's reasoning is based on the purported intention of the contracting Parties to the BIT.<sup>29</sup> Admittedly, a delicate balance must be struck between two conflicting considerations. On the one hand, it seems only reasonable to assume that the intention regarding the scope of the BIT dispute resolution provision varies according to the language used. The fact that some treaties expressly restrict the BIT tribunal's jurisdiction to treaty violations suggests that broader language is intended to encompass other types of disputes such as contractual ones. On the other hand, it may seem odd to interpret a treaty as creating a jurisdictional basis for the BIT tribunal in cases where it is not called upon to rule on an alleged violation of that treaty. There is always a danger in divorcing the jurisdictional provisions from the substantive terms of the same treaty in that it may suggest that the arbitral tribunal has jurisdiction but is invited to rule in a vacuum. This tension does not exist, however, when the treaty contains an observance of undertakings clause pursuant to which the breach of a contract entered into by the State party can also be characterized as a treaty violation.

**B. A BIT Tribunal's jurisdiction over contractual claims where the BIT contains an observance of undertakings clause**

In *SGS v. Pakistan*, the discussion regarding the Tribunal's jurisdiction over contractual claims also concerned the language contained in Article 11 of the BIT:

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.

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<sup>28</sup> *SGS v. Pakistan*, *supra* note 1, paras. 161-162 (Emphasis in original).

<sup>29</sup> On this issue, see the reservations expressed by Stanimir A. Alexandrov, *Introductory Note to International Centre for the Settlement of Investment Disputes (ICSID): SGS Société Générale de Surveillance S.A. v. Pakistan*, *supra* note 1, at 1288.



SGS argued that, under this provision, breaches by Pakistan of its contractual commitments amounted to infringements of the BIT.<sup>30</sup> In SGS's view, a breach of contract could also be "characterised as a violation of the Treaty. So the same facts, the same breach will be a violation of the contract in itself, and a violation of the Treaty."<sup>31</sup> Pakistan, on the other hand, submitted that the parties' contractual choice of forum controlled and that any claims under Article 11 were "second order" claims which could not ripen until after the PSI Agreement arbitrator, who had jurisdiction under the contractual dispute resolution clause, would decide upon a "first order" claim that a contractual commitment had been breached.<sup>32</sup> According to Pakistan, SGS's position resulted in eviscerating the parties' specific arbitration agreement in this case: "If the Tribunal accepted SGS's logic, it would negate routine forum selection clauses in thousands of State-investor contracts where States subject to BITs make routine commitments to investors."<sup>33</sup>

The main issue before the Tribunal was whether, under an observance of undertakings clause, a breach of the investment agreement could amount to a violation of the BIT. The Tribunal determined that States may "agree with each other in a BIT that henceforth, all breaches of each State's contracts with investors of the other State are forthwith converted into and to be treated as breaches of the BIT."<sup>34</sup> However, the Tribunal considered that "the legal consequences that the Claimant would have [it] attribute to Article 11 of the BIT [were] so far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party" that "clear and convincing evidence" was needed in the circumstances of the case to find that the intention of Switzerland and Pakistan when entering into the BIT had been to make such a commitment.<sup>35</sup> Interpreting the observance of undertakings clause under the Swiss-Pakistan BIT, the Tribunal held that there was no such evidence:

Applying [the] familiar norms of customary international law on treaty interpretation, we do not find a convincing basis for accepting the Claimant's

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<sup>30</sup> See the summary of the parties' position in *SGS v. Pakistan*, *supra* note 1, at paras. 43 *et seq.* and paras. 97-99.

<sup>31</sup> *Id.*, para. 99; see also para. 156.

<sup>32</sup> *Id.*, para. 54.

<sup>33</sup> *Id.*, para. 56.

<sup>34</sup> *Id.*, para. 173.

<sup>35</sup> *Id.*, para. 167.



contention that Article 11 of the BIT has had the effect of entitling a Contracting Party's investor, like SGS, in the face of a valid forum selection contract clause, to "elevate" its claim grounded solely in a contract with another Contracting Party, like the PSI Agreement, to claims grounded on the BIT, and accordingly to bring such contract claims to this Tribunal for resolution and decision.<sup>36</sup>

As a result, the Tribunal declined jurisdiction over SGS's claims alleging a violation of the observance of undertakings provision. It retained jurisdiction only over SGS's claims alleging violation of the more "traditional" provisions of the BIT such as fair and equitable treatment or the prohibition of expropriation measures without effective and adequate compensation.

The question of the meaning and scope of observance of undertakings clauses resurfaced subsequently in *SGS v. Philippines*. The solution reached by the Tribunal in that case again contrasted with the one reached in *SGS v. Pakistan*. There are in fact three different approaches to this type of clause, as reflected in *SGS v. Pakistan* and *SGS v. Philippines*.

The first approach simply denies any effect to the observance of undertakings clause and does not consider that the breach of a contract may amount to a violation of the investment treaty. This is the conclusion that was reached by the Tribunal in *SGS v. Pakistan* with respect to the dispute before it. The same reasoning was recently adopted in *Joy Mining v. Egypt*, where the claimant argued that the Tribunal had jurisdiction over disputes sounding in contract on the basis of the umbrella clause contained in Article 2(2) of the BIT between the United Kingdom and Egypt and, in the alternative, on the basis of the dispute resolution clause of the treaty. The Tribunal held that the disputes at issue, which related to the release of bank guarantees, were commercial and contractual disputes to be settled through the mechanism set forth by contract:

In this context, it could not be held that an umbrella clause inserted in the Treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty,

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<sup>36</sup> *Id.*, para. 165. See also the reasoning at paras. 166-173.



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.<sup>37</sup>

Under a second approach, the effect of an observance of undertakings clause is to convert a breach of contract into a violation of the investment treaty. The Tribunal in *SGS v. Pakistan* endorsed this approach in circumstances where it is established that this was the intention of the contracting Parties to the BIT:

167. Considering the widely accepted principle with which we started, namely, that 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, and considering further that the legal consequences that the Claimant would have us attribute to Article 11 of the BIT are so far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party, we believe that *clear and convincing evidence* must be adduced by the Claimant. Clear and convincing evidence of what? Clear and convincing evidence that such was indeed the *shared intent of the Contracting Parties to the Swiss-Pakistan Investment Protection Treaty in incorporating Article 11 in the BIT*. We do not find such evidence in the text itself of Article 11. We have not been pointed to any other evidence of the putative common intent of the Contracting Parties by the Claimant.

...

173. The Tribunal is not saying that States may not agree with each other in a BIT that henceforth, all breaches of each State's contracts with investors of the other State are forthwith converted into and to be treated as breaches of the BIT. What the Tribunal is stressing is that in this case, there is no clear and persuasive evidence that such

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<sup>37</sup> Joy Mining Machinery Limited v. The Arab Republic of Egypt (ICSID Case No. ARB/03/11), Award on jurisdiction of August 6, 2004, para. 81.



was in fact the intention of both Switzerland and Pakistan in adopting Article 11 of the BIT.<sup>38</sup>

A similar approach was recently adopted by the Arbitral Tribunal in *Salini v. Jordan*. Interpreting the provision invoked by the claimant as constituting an observance of undertakings clause, the Tribunal found that the only obligation undertaken by the Parties to the applicable BIT under that provision was to create and maintain a “legal framework” apt to guarantee the compliance of undertakings:

126. The Tribunal notes that Article 2(4) of the BIT between Italy and Jordan is couched in terms that are appreciably different from the provisions applied in the arbitral decisions and awards cited by the Parties [*SGS v. Pakistan* and *SGS v. Philippines*]. Under Article 2(4), each contracting Party committed itself to create and maintain in its territory a “legal framework” favourable to investments. This legal framework must be apt to guarantee to investors the continuity of legal treatment. It must in particular be such as to ensure compliance of all undertakings assumed under relevant contracts with respect to each specific investor. But under Article 2(4), each Contracting Party did not commit itself to “observe” any “obligation” it had previously assumed with regard to specific investments of investors of the other contracting Party as did the Philippines. It did not even guarantee the observance of commitments it had entered into with respect to the investments of the investors of the other Contracting Parties as did Pakistan. It only committed itself to create and maintain a legal framework apt to guarantee the compliance of all undertakings assumed with regard to each specific investor.

127. Of course, each State Party to the BIT between Italy and Jordan remains bound by its contractual obligations.

<sup>38</sup> *SGS v. Pakistan*, *supra* note 1, paras. 167 and 173 (Emphasis added). See also para. 172 of the Decision, whereby the Tribunal admitted that its decision did not “preclude the possibility that under exceptional circumstances, a violation of certain provisions of a State contract with an investor of another State might constitute violation of a treaty provision (like Article 11 of the BIT) enjoining a Contracting Party constantly to guarantee the observance of contracts with investors of another Contracting Party.”



However, this undertaking was not reiterated in the BIT. Therefore, these obligations remain purely contractual in nature and any disputes regarding the said obligations must be resolved in accordance with the dispute settlement procedures foreseen in the contract...<sup>39</sup>

On the point of the intention of the contracting Parties to the Swiss-Pakistan BIT with respect to Article 11, and given the *SGS v. Pakistan* Tribunal's conclusion that "the intent of the parties concluding the treaty in question would play a considerable role in interpreting the article," it is interesting to note that, after the *SGS v. Pakistan* decision was rendered and made public, the Swiss authorities spelled out in a letter to the ICSID Secretariat the intention of Switzerland when entering into the BIT:

It is with a great deal of concern that the Swiss authorities have taken note of the decision by the ICSID Tribunal with regard to BIT Article 11. On the one hand, the Swiss authorities are wondering why the Tribunal has not found it necessary to enquire about their view on the meaning of Article 11 in spite of the fact that the Tribunal attributed considerable importance to the intent of the Contracting Parties in drafting this Article and indeed put this question to one of the Contracting Parties (Pakistan). On the other, the Swiss authorities are alarmed about the very narrow interpretation given to the meaning of Article 11 by the Tribunal, which not only runs counter to the intention of Switzerland when concluding the Treaty but is quite evidently neither supported by the meaning of similar articles in BITs concluded by other countries nor by academic comments on such provisions....

With regard to the meaning behind provisions such as Article 11 the following can be said: ... Provisions such as Article 11 therefore occupy a middle ground between

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<sup>39</sup> *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan* (ICSID Case No. ARB/02/13), Decision on Jurisdiction of November 29, 2004, available on the ICSID internet website, at paras. 126-127. See also para. 96 ("[The dispute settlement procedures provided for in the Contract] cannot cover claims based on breaches of the BIT (including breaches of those provisions of the BIT guaranteeing fulfillment of contracts signed with foreign investors).") (Emphasis added).



these extreme positions. They are intended to cover commitments that a host State has entered into with regard to specific investments of an investor, or investments of a specific investor, which played a significant role in the investor's decision to invest or to substantially change an existing investment, i.e. commitments which were of such a nature that the investor could rely on them.... It is furthermore the view of the Swiss authorities that *a violation of a commitment of the kind described above should be subject to the dispute settlement procedures of the BIT.*<sup>40</sup>

In light of the disparity between the situations of host State and investor, who *ex hypothesi* has no access to the *travaux préparatoires* of the applicable IPT, the issuance of this letter raises the issue of how future arbitral tribunals will deal with questions of treaty interpretation when one of the contracting Parties to the treaty (the host State) is a party to the arbitration, but the other contracting Party (the investor's State) is not a disputing party and is therefore not in a position (or is unwilling) to provide clarifications<sup>41</sup> on the States' intention when entering into the BIT.<sup>42</sup>

Finally, under a third approach, the effect of an observance of undertakings clause is the conversion of a breach of contract into a violation of the treaty, but the BIT tribunal should not exercise its jurisdiction over claims asserted under this type of clause where there is a choice of forum mechanism in the underlying contract. This solution was adopted by the Tribunal in *SGS v. Philippines*, where the BIT between Switzerland and the Philippines included an observance of undertakings clause (Article X(2)) and the issues were articulated in terms similar to

<sup>40</sup> Note on the Interpretation of Article 11 of the Bilateral Investment Treaty between Switzerland and Pakistan in the light of the Decision of the Tribunal on Objections to Jurisdiction of ICSID in Case No. ARB/01/13 SGS Société Générale de Surveillance S.A. versus Islamic Republic of Pakistan, attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy-Secretary General dated October 1, 2003, published in 19 Mealey's: Int'l Arb. Rep. E 3 (Feb. 2004) (Emphasis added).

<sup>41</sup> Compare with Article 1128 of NAFTA, which provides that States other than the State party to the arbitration may make submissions to a Chapter Eleven tribunal on a question of interpretation of the Agreement, and with Article 2001(2)(c) of NAFTA, which provides that the Free Trade Commission established by the NAFTA Parties shall resolve disputes that may arise regarding the interpretation or application of the Agreement.

<sup>42</sup> On this issue, see also Thomas W. Wälde, *The 'Umbrella' (or Sanctity of Contract/Pacta Sunt Servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases*, *supra* note 1.



*SGS v. Pakistan*. In that case, the first step of the reasoning was formulated as follows:

128. To summarize the Tribunal’s conclusions on this point, Article X(2) makes it a *breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments*, which it has assumed with regard to specific investments.<sup>43</sup>

This view was justified by the object and purpose of the Swiss-Philippines BIT, which is to favour the protection of covered investments and “supports an effective interpretation of Article X(2).”<sup>44</sup> Yet again, notwithstanding this view, the Tribunal decided that it should give effect to the contractual dispute resolution mechanism as regards the determination of whether there had been a breach of contract:

But [Article X(2)] does not convert the issue of the *extent* or *content* of such obligations into an issue of international law. That issue (in the present case, the issue of how much is payable for services provided under the CISS Agreement) is still governed by the investment agreement. In the absence of other factors it could be decided by a tribunal constituted pursuant to Article VIII(2). The proper law of the CISS Agreement is the law of the Philippines, which in any event this Tribunal is directed to apply by Article 42(1) of the ICSID Convention. On the other hand, if some other court or tribunal has exclusive jurisdiction over the Agreement, the position may be different.<sup>45</sup>

This analysis is the same as the one adopted with respect to the BIT tribunal’s jurisdiction over contractual claims in the absence of an observance of undertakings clause. On the one hand, the Tribunal in *SGS v. Philippines* decided that it had jurisdiction over claims relating to the violation of the observance of undertakings clause, a jurisdiction that is absorbed by the Tribunal’s jurisdiction “with respect to a claim arising under the CISS Agreement, even though it may not involve any breach of the substantive standards of the BIT,”<sup>46</sup> and which results from the

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<sup>43</sup> *SGS v. Philippines*, *supra* note 18, para. 128 (Emphasis added).

<sup>44</sup> *Id.*, para. 116.

<sup>45</sup> *Id.*, para. 128 (Emphasis in original).

<sup>46</sup> *Id.*, para. 169.



broadly worded dispute resolution clause of the BIT. On the other hand, the Tribunal stayed the arbitration proceedings “pending a decision on the amount due but unpaid under the CISS Agreement, a matter which (if not agreed by the parties) is to be determined by the agreed contractual forum under Article 12 of the CISS Agreement.”<sup>47</sup>

This result is unlikely to be one that the contracting Parties to the Swiss-Philippines BIT intended when providing for the observance of undertakings clause in the treaty. If one accepts that a State’s undertaking in an IPT to comply with its commitments vis-à-vis investors means that a breach of contract amounts to an infringement of the treaty, the jurisdictional consequence of such an undertaking is that the BIT tribunal selected by an investor on the basis of the dispute resolution clause contained in the treaty may assert jurisdiction over such an undertaking, which is a treaty obligation. Observance of undertakings clauses simply reflect a dual commitment made by the host State in two different instruments: on the one hand, the commitment made in the State’s contractual relationship with the investor; on the other hand, the commitment made in the BIT vis-à-vis the investor’s State. The contract judge has jurisdiction over the first relationship, without such jurisdiction having any bearing on possible fork in the road provisions contained in the applicable BIT.<sup>48</sup> The BIT tribunal has jurisdiction over the second relationship, without any requirement for a prior determination made by a judge other than the BIT judge with respect to possible breaches of the underlying contract. It is commonly accepted that an international tribunal having jurisdiction under a treaty may take into account a contractual instrument in order to assess the facts pertinent to the issue of the violation of treaty standards. As spelled out by the *Vivendi* Committee, “it is one thing to exercise contractual jurisdiction (arguably exclusively vested in the administrative tribunals of Tucumán by virtue of the Concession Contract) and another to take into account the terms of a contract in determining whether there has been a breach of a distinct standard of international law, such as that reflected in Article 3 of the BIT [relating to fair and equitable treatment].”<sup>49</sup> Consistent with the

<sup>47</sup> *Id.*, para. 177(c).

<sup>48</sup> On this issue, see *CMS Gas Transmission Company v. The Republic of Argentina* (ICSID Case No. ARB/01/8), Decision of July 17, 2003, 42 ILM 788 (2003); *Azurix v. Argentina*, *supra* note 14; *Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic* (ICSID Case No. ARB/01/3), Decision of January 14, 2004, available on the internet (<http://ita.law.uvic.ca> and <http://www.asil.org/ilib/Enron.pdf>).

<sup>49</sup> *Vivendi v. Argentina*, *supra* note 13, para. 105. See also para. 103: “A State cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of its conduct as internationally unlawful under a treaty.”



intention of the parties to each instrument, the actual issue is not whether the treaty forum selection clause would “override”<sup>50</sup> or “set at naught”<sup>51</sup> an otherwise valid forum selection clause contained in the underlying contract, but whether each of those forum selection clauses may be given effect in their respective scope of application.

An historical examination of the origins of observance of undertakings clauses shows in the clearest manner that the intention of States negotiating and drafting such clauses is to permit a breach of contract to be effectively characterised as the breach of an international treaty obligation by the host State.<sup>52</sup> The main jurisdictional consequence of this characterisation is that a BIT tribunal, as distinct from the contract judge, may assert jurisdiction over claims arising out of the contract but with respect to the host State’s international obligations under the observance of undertakings clause. No conflict of jurisdiction arises out of this situation, as each tribunal asserts jurisdiction with respect to a distinct and independent cause of action.

In light of the increasing number of investment treaty arbitrations involving underlying contractual breaches,<sup>53</sup> it might make sense to better define the borders between the dispute settlement mechanisms of the investment treaty and the underlying contract. For example, BIT tribunals’ jurisdiction may be limited to the violation of the applicable treaty’s substantive provisions and standards, thereby reserving purely contractual claims, in the absence of an observance of undertakings clause, to the dispute resolution mechanism set forth in the underlying contract. In such situations, the treaty’s fork in the road provision would not be triggered when purely contractual claims have been referred to the contract judge, and the treaty judge could not assert jurisdiction over

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<sup>50</sup> *Id.*, footnote 69, at para. 98.

<sup>51</sup> *SGS v. Pakistan*, *supra* note 1, paras. 161 and 170.

<sup>52</sup> See Anthony A. Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, *supra* note 2; see also Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, *supra* note 4, at 130. For an examination of the observance of undertakings clauses in the 1967 OECD Draft Convention on the Protection of Foreign Property and of the Energy Charter Treaty, see also Emmanuel Gaillard, *La jurisprudence du CIRDI*, *supra* note 1, at 833-834; Thomas W. Wälde, *Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience*, *supra* note 2; Stanimir A. Alexandrov, *Introductory Note to International Centre for the Settlement of Investment Disputes (ICSID): SGS Société Générale de Surveillance S.A. v. Pakistan*, *supra* note 1, at 1287.

<sup>53</sup> On this issue, see, e.g., Stanimir A. Alexandrov, *Breaches of Contract and Breaches of Treaty. The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, *supra* note 1, at 555.



“contract claims which do not also amount to BIT claims,” as convincingly determined by the *SGS v. Pakistan* Tribunal. Correlatively, when a BIT tribunal asserts jurisdiction, it should effectively exercise such jurisdiction, be it over claims relating to the more “traditional” provisions of the treaty or over claims alleging the violation of an observance of undertakings clause.

