

# **The Relevance of Public International Law in International Commercial Arbitration: Investment Disputes**

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To say that public international law is relevant to international investment arbitration would be a gross understatement. In fact, international law is so ubiquitous in this area that it is fair to say that investment arbitration lies at the borderline of international and domestic law. This hybrid nature of investment arbitration is evident in a number of ways:

- It is manifested the **participants** in the proceedings.
- It emerges from the **remedies that it replaces**.
- It is mirrored by its **bases of jurisdiction**.
- It is apparent from the **types of claims** put forward in investment arbitration.
- It is reflected in the **law applicable** to the merits of the dispute.

## *1. Participants*

The mixed nature of investment arbitration is the most obvious evidence of its position between international law and domestic law. The host State, a subject of international law, is confronted by a private investor, most often a corporation established by domestic law.

## *2. Antecedent Arenas: the Remedies Replaced by Investor-State Arbitration*

Investment arbitration is designed to replace essentially two different forms of dispute settlement: diplomatic protection and litigation in domestic courts. Diplomatic protection is a classical institution of public international law. In the context of investment disputes, the investor's home State would espouse its national's claim and pursues it against the host State on the international plane. Litigation in domestic courts is the traditional way of settling disputes between private persons.

Both types of remedies were considered unsatisfactory for the settlement of investment disputes. Diplomatic protection is discretionary and political. Therefore, it offers no assurance of an effective outcome to the investor. Moreover, before diplomatic protection becomes

available, the investor must have exhausted all local remedies in the host State. Additionally, diplomatic protection is liable to lead to frictions in the relations between the two States.

Litigation in the host State's domestic courts is often seen as lacking the objectivity that the investor desires. In addition, domestic courts are bound to apply domestic law even if that law falls short of the standards provided by international law.

Litigation in the domestic courts of States other than the host State is liable to lead to problems like State immunity, the act of State doctrine and territorial jurisdiction. Therefore, it was never a promising alternative.

International arbitration is the most rational way to close this procedural gap between the traditional international law remedy of diplomatic protection and proceedings in domestic courts. It offers an objective international judicial procedure on the basis of internationally accepted standards that grants direct access to the investor without having to depend on its State of nationality.

### *3. Basis of Jurisdiction*

Investment arbitration, like any arbitration, is based on an agreement between the parties. An arbitration clause in an investment agreement between the host State and the investor follows the traditional method of consenting to commercial arbitration. Such arbitration clauses in direct agreements between the disputing parties have been the basis of a considerable number of investment arbitrations.<sup>1</sup>

More recently, the typical basis for the jurisdiction of tribunals in investment arbitration has not been a contract between the parties but a treaty. Most bilateral investment treaties (BITs) contain clauses offering access to international arbitration to the nationals of one of the States

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<sup>1</sup> See e.g. *Holiday Inns v. Morocco, Lalive*, The First 'World Bank' Arbitration, 51 British Year Book of International Law 128 (1980); *Adriano Gardella v. Ivory Coast*, 1 ICSID Reports 287; *Kaiser Bauxite v. Jamaica*, 1 ICSID Reports 301, 303/4; *AGIP v. Congo*, 1 ICSID Reports 313; *Benvenuti & Bonfant v. Congo*, 1 ICSID Reports 340/1; *Amco v. Indonesia*, 1 ICSID Reports 392; *Klöckner v. Cameroon*, 2 ICSID Reports 10, 13; *SOABI v. Senegal*, 2 ICSID Reports 179, 204, 272; *LETCO v. Liberia*, 2 ICSID Reports 347, 350/1; *Atlantic Triton v. Guinea*, 3 ICSID Reports 17; *Vaccum Salt v. Ghana*, 4 ICSID Reports 329; *Mobil Oil v. New Zealand*, 4 ICSID Reports 147, 158.

parties to the treaty against the other State party to the treaty. The same method is used by a number of regional multilateral treaties such as the NAFTA<sup>2</sup> and the Energy Charter Treaty.<sup>3</sup>

The treaty clause as such does not establish jurisdiction. It is no more than an offer by the States parties to the treaty to eligible investors. The offer may be taken up by an investor who is a national of the other State party to the BIT (or of another State party to the multilateral treaty). The investor can do so either by addressing a formal acceptance to the host State or simply by instituting proceedings.<sup>4</sup>

The result is an agreement between the investor and the host State on the basis of a treaty between the host State and the investor's home State. Again, the interaction of public international law and of private law is apparent. The distinction between the treaty containing the offer of consent to arbitration and the arbitration agreement brought about by the acceptance of that offer is not just theoretical formalism. The time of consent to jurisdiction is only the acceptance of the offer by the investor.<sup>5</sup> In addition, jurisdiction will only exist to the extent that offer and acceptance coincide. A broad offer of jurisdiction contained in a treaty may be accepted by the investor only in narrow terms, for instance relating only to certain investment operations.

The mixed nature of the agreements to arbitrate is also reflected in their interpretation.<sup>6</sup> Considerations of both international law and domestic law come into play. For instance, in *Amco v. Indonesia* jurisdiction was based on an investment application that had been accepted by the Government. In the Tribunal's view, the proper method for the interpretation of the consent agreement was to read it in the spirit of the ICSID Convention and in the light of its objectives. The Tribunal said that it would determine the true common will and intention of the parties

. . . from the normal expectations of the parties, as they may be established in view of the agreement as a whole, and of the aim and the

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<sup>2</sup> Article 1122.

<sup>3</sup> Article 26.

<sup>4</sup> This method of consenting to arbitration was first employed in *AAPL v. Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 250/1. For a discussion of the circumstances of the investor's acceptance see *Tokios Tokelés v. Ukraine*, Decision on Jurisdiction, 29 April 2004, at paras. 94-100.

<sup>5</sup> On the significance of the time of consent to ICSID jurisdiction see *Schreuer, C.*, *The ICSID Convention: A Commentary* (2001) pp. 226/227.

<sup>6</sup> See also *C. Schreuer*, *The Interpretation of ICSID Arbitration Agreements*, in: *International Law: Theory and Practice, Essays in Honour of Eric Suy* 719-735 (1998).

spirit of the Washington Convention as well as of the Indonesian legislation and behaviour.<sup>7</sup>

In *SPP v. Egypt*, jurisdiction was based on a provision in Egyptian legislation. The Tribunal rejected the contention that it followed that the parties' consent to ICSID arbitration had to be interpreted in accordance with Egyptian law. Neither did it accept the argument that the arbitration clause was subject to the rules of treaty interpretation. The issue was whether certain unilaterally enacted legislation had created an international obligation under a multilateral treaty (the ICSID Convention). This involved statutory and treaty interpretation as well as certain aspects of international law governing unilateral juridical acts. The Tribunal said:

... in deciding whether in the circumstances of the present case Law No. 43 constitutes consent to the Centre's jurisdiction, the Tribunal will apply general principles of statutory interpretation taking into consideration, where appropriate, relevant rules of treaty interpretation and principles of international law applicable to unilateral declarations.<sup>8</sup>

In *CSOB v. Slovakia* jurisdiction was based on an agreement between the parties that referred to a BIT. Although the BIT had never entered into force, the Tribunal concluded that the parties by referring to the BIT had intended to incorporate the ICSID clause in the BIT into their agreement.<sup>9</sup> With respect to the interpretation of the consent agreement the Tribunal had no doubt that it was governed by international law:

The question of whether the parties have effectively expressed their consent to ICSID jurisdiction is not to be answered by reference to national law. It is governed by international law as set out in Article 25(1) of the ICSID Convention.<sup>10</sup>

In adopting the proper method for the interpretation of consent agreements, their mixed role between international law and domestic law should always be kept in mind. An investment agreement between the host State and the investor containing a consent clause is neither a treaty nor simply a contract under domestic law. While a BIT or other treaty providing for consent to arbitration is clearly subject to the principles of treaty interpretation, an arbitration clause in a treaty is only the first step towards consent between the parties. The offer must be

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<sup>7</sup> *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 398. See also pp. 399/400.

<sup>8</sup> *SPP v. Egypt*, Decision on Jurisdiction, 14 April 1988, 3 ICSID Reports 142/3.

<sup>9</sup> *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, 5 ICSID Reports 347-349.

<sup>10</sup> At p. 344.

accepted in writing by the investor. The perfected consent is an agreement between the host State and the investor.

It follows that questions of jurisdiction are not subject to the law applicable to the merits of the case. Rather, questions of jurisdiction are governed by their own system which is determined by the peculiar mixed nature of the agreement to arbitrate in investment disputes.

In the words of the Tribunal in *CMS v. Argentina*:

Article 42 [of the ICSID Convention]<sup>11</sup> is mainly designed for the resolution of disputes on the merits and, as such, it is in principle independent from the decision on jurisdiction, governed solely by Article 25 of the [ICSID] Convention and those other provisions of the consent instrument which might be applicable, in the instant case the Treaty provisions.<sup>12</sup>

#### 4. Types of Claims

In an investment dispute the claimant will typically argue a violation of international law standards. Most frequently these standards will be contained in a BIT or another treaty for the protection of investments. At times, other standards of international law especially of customary international law will also be invoked.

An investor may also base a claim on a breach of contract. A breach of contract will not necessarily amount to a violation of international law.<sup>13</sup> The power of an arbitral tribunal to entertain contract claims depends on the terms of its jurisdiction.

Under the NAFTA it is clear that a tribunal can only entertain a claim that the host State is in breach of the obligations under Chapter Eleven of the NAFTA itself.<sup>14</sup> A NAFTA tribunal will not entertain a claim for breach of contract.<sup>15</sup>

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<sup>11</sup> Article 42 of the ICSID Convention deals with the law applicable to the dispute.

<sup>12</sup> *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 88, 42 ILM 788.

<sup>13</sup> *S. M. Schwebel*, On Whether the Breach by a State of a Contract with an Alien is a Breach of International Law, in: *International Law at the Time of its Codification, Essays in Honour of Roberto Ago, III*, 1987, p.401; *Sir Robert Jennings/Sir Arthur Watts*, *Oppenheim's International Law*, Ninth Ed., Vol. 1 p. 927 (1996); See also American Law Institute, *Restatement of the Law, Foreign Relations Law of the United States*, 1986, §712, Comment h, vol.2, p. 201: "... not every repudiation or breach by a state of a contract with a foreign national constitutes a violation of international law."

<sup>14</sup> Article 1116 para.1.

<sup>15</sup> *Azinian v. Mexico*, Award, 1 November 1998, 5 ICSID Reports 269, 287/88, para. 87; *Waste Management v. Mexico*, Award, 30 April 2004, paras. 73, 175-177.

Similarly, Article 26 of the Energy Charter Treaty, dealing with investor/State dispute settlement, covers only disputes concerning an alleged breach of Part III of the ECT itself.

Some BITs are similarly restrictive. They cover only disputes relating to an “obligation ... under this agreement”.<sup>16</sup> In other words, jurisdiction exists only for claims of BIT violations.<sup>17</sup> Under these treaty provisions contract claims would not be admitted.

By contrast, other treaties providing for investment arbitration do not restrict the jurisdiction of tribunals to claims based on breaches of international law. They extend the tribunals’ jurisdiction to “any dispute relating to investments”.<sup>18</sup> On the basis of these wider definitions of arbitrable disputes, the majority of tribunals have found that jurisdiction is not restricted to claims asserting violations of the BITs’ substantive provisions but includes contract claims.<sup>19</sup> In other words, under these wider jurisdictional provisions not only claims arising from international law but also contract claims are covered.

Some treaties for the protection of investments contain clauses that guarantee the observance of obligations or commitments entered into vis-à-vis foreign investors. An example is contained in Article 10(1) of the ECT:

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.

Similar clauses may also be found in BITs.<sup>20</sup> Clauses of this kind are often referred to as “umbrella clauses” because they put contractual commitments under the treaties’ protective umbrella. There is broad consensus that the effect of such a clause is to make compliance with

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<sup>16</sup> See, for example, Article 9(1) of the Netherlands–Venezuela BIT.

<sup>17</sup> See also Article X(1) of the Costa Rica–Paraguay BIT which contains an investor–State dispute settlement clause covering only disputes “*respecto a cuestiones reguladas por el presente Acuerdo*” (“in respect of questions regulated by the present Agreement”).

<sup>18</sup> See, for example, Article 8(1) of the Argentina–France BIT; Article 9(1) of the Italy–Jordan BIT; Article 8(1) of the Egypt–United Kingdom BIT.

<sup>19</sup> See, for example, *Salini v. Morocco*, 6 ICSID Reports 398, 415 at paras. 59–62; *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 356, para. 55; *SGS Société Générale de Surveillance S.A. v. The Republic of the Philippines*, Decision on Jurisdiction, 29 January 2004, paras. 130–135; *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, at FN 42 at para. 52. But see *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, para. 161.

<sup>20</sup> See e.g. Article 2(2) of the Egypt–United Kingdom BIT: Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party.

investment contracts and other undertakings by the host State a treaty obligation.<sup>21</sup> Arbitral practice on the effect of umbrella clauses is still unsettled at the time of writing.<sup>22</sup>

To make matters even more complicated, a particular course of action by the host State may well constitute a breach of contract and a violation of international law.<sup>23</sup> The two categories are by no means mutually exclusive. Rather, two different standards have to be applied to determine whether one or the other or both have occurred.<sup>24</sup> “A state may breach a treaty without breaching a contract, and *vice versa*, ... , whether there has been a breach of the BIT and whether there has been a breach of contract are different questions.”<sup>25</sup>

Therefore, if jurisdiction is based on a BIT, claims related to contractual performance may fall under the tribunal’s competence if one of the following three conditions is met:

- the claimant asserts that the breach of the contract amounts to a violation of one or several the BIT’s substantive standards (e.g. fair and equitable treatment, full protection and security, restrictions on the right to expropriate etc.),
- the arbitration clause in the BIT is not restricted to violations of the BIT’s substantive provisions but covers disputes with respect to investments in general,
- the BIT contains an “umbrella clause” converting a breach of contract into a violation of the BIT.

The distinction between claims under international law (treaty claims) and claims arising under domestic law (contract claims) has played a particularly prominent role in the context of contractual forum selection clauses. In a number of cases investment contracts contained provisions submitting disputes arising from these contracts to local courts.

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<sup>21</sup> *P. Weil*, Problèmes relatifs aux contrats passés entre un Etat et un particulier, 128 Recueil des Cours 130 (1969-III); *F. A. Mann*, British Treaties for the Promotion and Protection of Investments, 52 British Year Book of International Law (1981), 241, at p. 246; *R. Dolzer/M. Stevens*, Bilateral Investment Treaties pp. 81/82 (1995); *I.F.I. Shihata*, Applicable Law in International Arbitration: Specific Aspects in the Case of the Involvement of State Parties, in: The Works Bank in a Changing World, vol. II, p. 601 (1995); *J. Karl*, The Promotion and Protection of German Foreign Investment Abroad, 11 ICSID Review – FILJ 1, 23 (1996); *K. J. Vandeveld*, United States Investment Treaties: Policy and Practice (1992), at p. 78; *C. Schreuer*, Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road, 5 The Journal of World Investment & Trade 231, 249 (2004); *S.A. Alexandrov*, Breaches of Contract and Breaches of Treaty, 5 The Journal of World Investment & Trade 555, 564-572 (2004).

<sup>22</sup> *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1290, paras. 163-173; *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, paras. 113-129; *Joy Mining v. Egypt*, Award on Jurisdiction, 6 August 2004, para. 81.

<sup>23</sup> See *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 189, 228/229 at paras. 164-167.

<sup>24</sup> *Azinian v. Mexico*, Award, 1 November 1998, 5 ICSID Reports 269, 287/88; *Waste Management v. Mexico*, Award, 30 April 2004, paras. 163 *et seq.*

<sup>25</sup> *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 365, paras.95, 96.

When the investors instituted international arbitration on the basis of a BIT, the host States would object contending that the contractual forum selection clause, pointing to domestic litigation, constituted a waiver of international arbitration.<sup>26</sup> These objections were mostly unsuccessful. The tribunals held that the contractual clauses pointing to domestic courts did not deprive them of their jurisdiction to hear claims for violations of international law, especially BIT, claims.<sup>27</sup> With respect to the contract claims the outcome of these cases was mixed. In some cases the tribunals found that they also had the power to decide claims for breach of contract, at least in principle.<sup>28</sup> Two tribunals found that they lacked the power to decide on contract claims despite an umbrella clause.<sup>29</sup> Another Tribunal found that it had jurisdiction but found the claim inadmissible.<sup>30</sup>

A closely related question is: who decides at the stage of jurisdiction whether there is a claim under international law or merely a contract claim? Is it sufficient for the claimant to invoke some provision of a BIT?

Most tribunals have held that, in principle, the characterization of the claim for purposes of jurisdiction is undertaken by the claimant.<sup>31</sup> The Tribunal will decide on the accuracy of this provisional characterization in its decision on the merits when it determines whether or not international law, especially guarantees under a BIT, has indeed been violated. But the

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<sup>26</sup> See *O. Spiermann*, Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties, 20 *Arbitration International* 179 (2004).

<sup>27</sup> *Salini Costruttori SpA et Italstrade SpA c/ Royaume du Maroc*, Decision on Jurisdiction, 23 July 2001, *Journal de Droit International* 196 (2002), 6 ICSID Reports 400; *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Award, 21 November 2000, 5 ICSID Reports 296, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340; *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003) paras. 70-76; *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1289 (2003) paras. 146-174; *Azurix v. Argentina*, Decision on Jurisdiction, 8 December 2003, 43 ILM 262 (2004) paras. 75-85; *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004; *Enron v. Argentina*, Decision on Jurisdiction, 14 January 2004, paras. 89-94;

<sup>28</sup> *Salini Costruttori SpA et Italstrade SpA c/ Royaume du Maroc*, Decision on Jurisdiction, 23 July 2001, *Journal de Droit International* 196 (2002); 42 ILM 609; *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, paras. 113-135.

<sup>29</sup> *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1289 (2003) paras. 146-174; *Joy Mining v. Egypt*, Award on Jurisdiction, 6 August 2004, para. 81.

<sup>30</sup> *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, para. 154: “a party to a contract cannot claim on that contract without itself complying with it”.

<sup>31</sup> *Wena Hotels v. Egypt*, Decision on Jurisdiction, 25 May 1999, 41 ILM 881, 890 (2002); *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Award, 21 November 2000, 5 ICSID Reports 296 para. 53, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, para. 74; *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1289 (2003) para. 145; *Azurix v. Argentina*, Decision on Jurisdiction, 8 December 2003, 43 ILM 262 (2004), para. 76; *Enron v. Argentina*, Decision on Jurisdiction, 14 January 2004, para. 67; *Siemens v. Argentina*, Decision on Jurisdiction, 3 August 2004, para. 180.

claimant's categorization of a claim as being based on international law is not only provisional but also subject to correction by the tribunal in case of obvious misdescription.<sup>32</sup> Other tribunals have occasionally required a more objective standard already for purposes of jurisdiction referring to the "essential basis of a claim"<sup>33</sup> or asserting that the test was an objective one.<sup>34</sup>

The type of claim put forward does not necessarily determine the law governing the dispute. Even a claim based purely on international law may give rise to matters of domestic law. For instance in *Occidental v. Ecuador*,<sup>35</sup> the Claimant based its claims exclusively on the applicable BIT. Yet the Tribunal went through an elaborate analysis of Ecuadorean tax law<sup>36</sup> and an interpretation of the investment contract<sup>37</sup> before finding that certain provisions of the BIT had been violated.

##### 5. *The Law Governing the Merits*

By far the most important question concerning the relevance of public international law in investment arbitration is the law governing the substance of the dispute. The choice of the applicable law can be made in a variety of ways. The governing law may be agreed as between the parties to the dispute, that is the host State and the investor. Some treaties and other international documents providing for investor/State arbitration refer to the parties' agreement on choice of law.<sup>38</sup>

Some of the relevant treaties contain choice of law clauses in case there is no agreement on applicable law between the parties. For instance, The ICSID Convention refers primarily to any agreement on choice of law that the parties may have reached. In the absence of such an agreement, it provides for the application of the host State's law and international law.

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<sup>32</sup> *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 390, 405.

<sup>33</sup> *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, para. 98.

<sup>34</sup> *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, paras. 156-164; *Occidental Exploration and Production Company v. The Republic of Ecuador*, Final Award, 1 July 2004, paras. 47, 80, 89, 92; *Joy Mining Machinery Limited v. The Arab Republic of Egypt*, Award on Jurisdiction, 6 August 2004.

<sup>35</sup> *Occidental Exploration and Production Company v. The Republic of Ecuador*, Final Award, 1 July 2004.

<sup>36</sup> Paras. 117-144.

<sup>37</sup> Paras. 95-115.

<sup>38</sup> Article 42 ICSID Convention; Article 54 of the ICSID Additional Facility Rules. See also Article 33 of the UNCITRAL Arbitration Rules. Of course the UNCITRAL Rules were not drafted with investor/State arbitration in mind. But they are also used in investment disputes.

In turn, treaty provisions on the applicable law may form the basis of an agreement between the parties. Many of the treaties that offer investor/State arbitration such as NAFTA, the Energy Charter Treaty and some BITs contain provisions on applicable law. By taking up the offer of arbitration, the investor also accepts the choice of law clause contained in the treaty's dispute settlement provision. Therefore, the treaty's provision on applicable law becomes part of the arbitration agreement. In other words, the clause on applicable law in the treaty becomes a choice of law agreed by the parties to the arbitration.<sup>39</sup>

There is a considerable body of substantive international law protecting foreign investors. It consists of treaty law, contained mostly BITs, but also multilateral treaties such as NAFTA and the Energy Charter Treaty. But there is also a good deal of customary international law that remains relevant. This customary international law includes various aspects of state responsibility, and such issues as denial of justice, the law on expropriation, the nationality of individuals and corporations.

But investors are also subject to the host State's domestic law. In every case there is relevant legislation like commercial law, company law, administrative law, labour law, tax law, foreign exchange regulations, real estate law and many other areas of the host State's legal system.

The relevant rules on the law applicable in investment disputes are far from uniform. Some clauses governing the applicable law in investment disputes refer exclusively to international law. For instance, Chapter 11, Section B of the NAFTA, dealing with the settlement of investor/State disputes, refers only to international law including the NAFTA itself:

**Article 1131: Governing Law**

1. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.<sup>40</sup>

Similarly, the Energy Charter Treaty's provision on investor/State dispute settlement provides:

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<sup>39</sup> *A. R. Parra*, Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 ICSID Review—FILJ 287, 332 (1997); *P. Peters*, Dispute Settlement Arrangements in Investment Treaties, 22 Netherlands Yearbook of International Law 91, 147/8 (1991); *I. F. I. Shihata/A. R. Parra*, The Experience of the International Centre for Settlement of Investment Disputes, 14 ICSID Review—FILJ 299, 336 (1999). See also the analysis in *Antoine Goetz v. Burundi*, Award, 10 February 1999, 6 ICSID Reports 5, para. 94.

<sup>40</sup> 32 ILM 605, 645 (1993).

## Article 26

### Settlement of Disputes between an Investor and a Contracting Party

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(6) A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.<sup>41</sup>

A number of BITs also merely refer to international law including the substantive rules of the BIT itself.<sup>42</sup>

At the other extreme are some agreements between parties to investment disputes that simply refer to the host State's domestic law.<sup>43</sup> The choice of the law of the investor's home country or of the law of a third State is rare, but it sometimes occurs in the context of loan contracts.<sup>44</sup>

In the majority of cases the provisions on applicable law include international law as well as host State law.<sup>45</sup> These compound choice of law clauses combining domestic and international law are most practicable. Investments typically are complex operations involving numerous transactions of different kinds. Most of these transactions will take place under the local law. These transactions will have their closest connection to the host State's legal system. At the same time, the application of international law gives the investor assurance that the international minimum standard will be observed.<sup>46</sup>

The most prominent example for a combined choice of law clause is the residual rule in Article 42 of the ICSID Convention which, in the absence of an agreement of the parties, directs the tribunal to apply host State law and applicable rules of international law:

## Article 42

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<sup>41</sup> 34 ILM 360, 400 (1995).

<sup>42</sup> For a detailed list of examples see *E. Gaillard/Y. Banifatemi*, The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process, 18 ICSID Review 375, 377 (2003).

<sup>43</sup> See e.g. *Attorney-General v. Mobil Oil NZ Ltd.*, New Zealand, High Court, 1 July 1987, 4 ICSID Reports 123. See also *MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 ICSID Reports 94. In that case the applicable law was the law of Guinea subject to the agreement of the parties.

<sup>44</sup> See e.g. *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 242. The choice of English law to the exclusion of Egyptian law turned out to be decisive for the computation of interest.

<sup>45</sup> See already the Deeds of Concession concluded between Libya and two American companies between 1955 and 1968 in *Texaco v. Libya*, Award, 19 January 1977, 53 ILR 389, 404. See also *LIAMCO v. Libya*, Award, 12 April 1977, 62 ILR 140, 172; *British Petroleum v. Libya*, 10 October 1973, 53 ILR 297; *AGIP v. Congo*, Award, 30 November 1979, 1 ICSID Reports 313; *Kaiser Bauxite v. Jamaica*, Decision on Jurisdiction, 6 July 1975, 1 ICSID Reports 301.

<sup>46</sup> See also *Z. Douglas*, The Hybrid Foundations of Investment Treaty Arbitration, 74 The British Year Book of International Law 151, 194 (2003).

(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.<sup>47</sup>

Most tribunals applying this provision examined the issues before them under both systems of law.<sup>48</sup> In some cases the tribunals were simply content to find that both systems of law reached the same result.<sup>49</sup>

The prevailing theory on the relationship of international law to host State law under the second sentence of Article 42(1) is the doctrine of the supplemental and corrective function of international law vis-à-vis domestic law. This goes back to a statement by Mr *Broches* in the course of the ICSID Convention's drafting to the effect that international law would come into play both in the case of a lacuna in domestic law and in the event of an inconsistency between the two.<sup>50</sup>

Tribunals have since adopted the theory of the supplemental and corrective function of international law.<sup>51</sup> The *ad hoc* Committee in *Amco v. Indonesia* put this doctrine into succinct words:

...Article 42(1) of the Convention authorizes an ICSID tribunal to apply rules of international law only to fill up lacunae in the applicable domestic law and to ensure precedence to international law norms where the rules of the applicable domestic law are in collision with such norms.<sup>52</sup>

But there are indications that tribunals, while paying lip-service to the theory of the supplemental and corrective nature of international law, gave it more than a mere ancillary or

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<sup>47</sup> 4 ILM 532, 539 (1965).

<sup>48</sup> But see *SOABI v. Senegal*, Award, 25 February 1988, 2 ICSID Reports 221.

<sup>49</sup> *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, 1 ICSID Reports 283, p. 287; *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, 1 ICSID Reports 330, p. 357; *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 9, p. 63; *Amco v. Indonesia*, Award, 20 November 1984, 1 ICSID Reports 413, pp. 452, 466-467, 473, 490-494, 498-501, 504, 506. For a fuller discussion of the application of domestic law and of international law in these cases see *C. Schreuer*, *The ICSID Convention: A Commentary*, pp. 624-625.

<sup>50</sup> History of the Convention, Vol. II, p. 804. See also *A. Broches*, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 *Recueil des Cours* 331, 392 (1972-II).

<sup>51</sup> *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, 2 ICSID Reports 122; *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 358/9; *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 580; *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 208; *CDSE v. Costa Rica*, Award, 17 February 2000, 15 ICSID Review – FILJ 191 (2000); *Autopista v. Venezuela*, Award, 23 September 2003, paras. 101-105.

<sup>52</sup> *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, 1 ICSID Reports 515.

subsidiary role. The second Tribunal in the resubmitted case of *Amco v. Indonesia* called it a distinction without a difference:

40. This Tribunal notes that Article 42(1) refers to the application of host-state law and international law. If there are no relevant host-state laws on a particular matter, a search must be made for the relevant international laws. And, where there are applicable host-state laws, they must be checked against international laws, which will prevail in case of conflict. Thus international law is fully applicable and to classify its role as “only” “supplemental and corrective” seems a distinction without a difference.<sup>53</sup>

The Tribunal in the *CDSE v. Costa Rica* concluded that ultimately international law is controlling:

64. ... To the extent that there may be any inconsistency between the two bodies of law, the rules of public international law must prevail. Were this not so in relation to takings of property, the protection of international law would be denied to the foreign investor and the purpose of the ICSID Convention would, in this respect, be frustrated.

65. The parties' apparently divergent positions lead, in substance, to the same conclusion, namely, that, in the end, international law is controlling. The Tribunal is satisfied that, under the second sentence of Article 42(1), the arbitration is governed by international law.<sup>54</sup>

Similarly, the *ad hoc* Committee in *Wena Hotels v. Egypt* came to the conclusion that “international law can be applied by itself if the appropriate rule is found in this other ambit” and that this “has the effect to confer on the Tribunal a certain margin and power for interpretation.”<sup>55</sup>

Most commentators agree that the function of international law is to close any gaps in domestic law and to prevent any violations of international law that otherwise could arise in the application of the host State’s law.<sup>56</sup> There are authors who put a stronger emphasis on

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<sup>53</sup> *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 580.

<sup>54</sup> *CDSE v. Costa Rica*, Award, 17 February 2000, 5 ICSID Reports 153, 170.

<sup>55</sup> *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, 6 ICSID Reports 129, 138.

<sup>56</sup> *G. R. Delaume*, Transnational Contracts, Applicable Law and Settlement of Disputes Ch. XV, 68 *et seq.* (1990); *P. Feuerle*, International Arbitration and Choice of Law under Article 42 of the Convention on the Settlement of Investment Disputes, 4 Yale Studies in World Public Order 89, 118/119 (1977); *A. Giardina*, The International Centre for Settlement of Investment Disputes between States and Nationals of other States (ICSID), *in*: Essays on International Commercial Arbitration (*P. Sarcevic* ed.) 214 at 217 (1989); *B. Goldman*, Le droit applicable selon la Convention de la B.I.R.D., du 18 mars 1965, pour le règlement des différends relatifs aux investissements entre Etats et ressortissants d’autres Etats, *in*: Investissements Etrangers et Arbitrage entre Etats et Personnes Privées, La Convention B.I.R.D. 133, 151 (1969); *M. Hirsch*, The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes 134, 140/1 (1993); *G. Jaenicke*, The Prospects for International Arbitration: Disputes between States and Private Enterprises, *in*: International Arbitration: Past and Prospects (*A. H. A. Soons* ed.) 155 at 159 (1990); *P. Kahn*, The Law Applicable to Foreign Investments: The

the host State's law<sup>57</sup> and others that stress the importance of international law.<sup>58</sup> *Emmanuel Gaillard* and *Yas Banifatemi* argue that the doctrine of the supplemental and corrective function of international law should be abandoned, and that international law should be directly accessible to the tribunal without initial scrutiny of host state law. The extent to which any rules of host State law and international law are to be applied should be left to the tribunal's discretion in any given case.<sup>59</sup>

Sometimes BITs, in provisions dealing with applicable law, also combine the host State's domestic law and international law. A frequently used formula lists a) the host State's law, b) the BIT itself together with other treaties, c) any contract relating to the investment and d) general international law.

An example of such a provision may be found in the Argentina/Netherlands BIT of 1992:

7. The arbitration tribunal addressed in accordance with paragraph (5) of this Article shall decide on the basis of the law of the Contracting Party which is a party to the dispute (including its rules on the conflict of laws), the provisions of the present Agreement, special Agreements concluded in relation to the investment concerned as well as such rules of international law as may be applicable.<sup>60</sup>

Tribunals applying combined choice of law clauses of this kind in BITs have also usually addressed both systems of law.<sup>61</sup> They did not develop any doctrinal model like the one on

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Contribution of the World Bank Convention on the Settlement of Investment Disputes, 44 *Indiana Law Journal* 1, 27-29 (1968); *E. Lauterpacht*, The World Bank Convention on the Settlement of International Investment Disputes, in: *Recueil d'études de droit international en hommage à Paul Guggenheim* 642, 660 (1968); *M. Rubino-Sammartano*, *International Arbitration Law* 55 (1990); *O. Chukwumerije*, *International Law and Municipal Law in ICSID Arbitration*, 1 *Canadian Journal of International Business Law and Policy* 61, 82 *et seq.* (1996); *G. Elombi*, *ICSID Awards and the Denial of Host State Law*, 11 *Journal of International Arbitration* 61, 66 *et seq.* (1994); *V. C. Igbokwe*, *Developing Countries and the Law Applicable to International Arbitration*, 14 *Journal of International Arbitration* 99, 114 *et seq.* (1997); *N. Nassar*, *Internationalization of State Contracts: ICSID, The Last Citadel*, 14 *Journal of International Arbitration* 185, 202 *et seq.* (1997); *I.F.I. Shihata/A.R. Parra*, *Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*, 9 *ICSID Review - FILJ* 183 (1994); *C. Schreuer*, *The ICSID Convention: A Commentary*, 622-631 (2001).

<sup>57</sup> *W. M. Reisman*, *The Regime for Lacunae in the ICSID Choice of Law Provision and the Question of its Threshold*, 15 *ICSID Review - FILJ* 362 (2000).

<sup>58</sup> *P. Weil*, *The State, the Foreign Investor and International Law: The No Longer Stormy Relationship of a Ménage À Trois*, 15 *ICSID Review - FILJ* 401 (2000). At p. 409: "The reference to the domestic law of the host State, even if designed only to ascertain whether it is, or is not, compatible with international law, is indeed a pointless exercise, ..."

<sup>59</sup> *E. Gaillard/Y. Banifatemi*, *The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process*, 18 *ICSID Review* 375, 403-411 (2003).

<sup>60</sup> *Argentina/Netherlands BIT*, 20 October 1992.

<sup>61</sup> But see the Partial Award in *CME v. Czech Republic*, 13 September 2001, in which the Tribunal explicitly declined to apply Czech law. The relevant BIT between The Czech Republic and The Netherlands directed the

the supplementary and corrective function of international law but proceeded to apply international law and the host State's law as it appeared appropriate to them. In other words, they have developed a more sophisticated system that identifies each legal question in its proper context and makes a decision on the applicable law issue by issue.

In *Fedax v. Venezuela*<sup>62</sup> the Tribunal applied the Netherlands/Venezuela BIT which contained a provision on applicable law that referred to the host State's law and to international law.<sup>63</sup> The subject-matter of the dispute was unpaid promissory notes. The Tribunal made the following general statement on the applicable law:

... the various sources of the applicable law referred to in Article 9(5) of the Agreement [i.e. the BIT], including the laws of the Contracting Party, the Agreement, other special agreements connected with the investment and the general principles of international law, have all had an important and supplementary role in the consideration of this case as well as in providing the basis for the decision on jurisdiction and the award on the merits. This broad framework of the applicable law further confirms the trends discernible in ICSID practice and decisions.<sup>64</sup>

The Tribunal found that the purchase of the promissory notes constituted an investment under the ICSID Convention and the BIT. The obligation to honour the obligations arising from them arose directly from the BIT.<sup>65</sup> On the other hand, the promissory notes were governed by the Venezuelan Commercial Code and by the Law on Public Credit.<sup>66</sup>

In *Maffezini v. Spain*,<sup>67</sup> the rule on applicable law in the Argentina/Spain BIT similarly provided for the application of host State and international law.<sup>68</sup> The subject-matter of the

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Tribunal to take into account host state law, the BIT together with other relevant treaties special agreements relating to the investment and general principles of international law. In the Final Award, 14 March 2003 at paras. 396 et seq., the Tribunal explained that the pertinent clause in the BIT merely directed it to take into account rather than apply these sources of law. Curiously it then proceeded to apply Czech law to the determination of the quantum of damages.

<sup>62</sup> *Fedax v. Venezuela*, Award, 9 March 1998, 5 ICSID Reports 200.

<sup>63</sup> Netherlands/Venezuela BIT, Article 9(5): The arbitral award shall be based on:

- the law of the Contracting Party concerned;
- the provisions of this Agreement and other relevant Agreements between the Contracting Parties;
- the provisions of special agreements relating to the investments;
- the general principles of international law; and
- such rules of law as may be agreed by the parties to the dispute.

<sup>64</sup> At para. 30. Footnote omitted.

<sup>65</sup> At para. 29.

<sup>66</sup> At para. 30.

<sup>67</sup> *Maffezini v. Spain*, Award, 13 November 2000, 5 ICSID Reports 419.

<sup>68</sup> Argentina/Spain BIT, Article 10(5): The Arbitral Tribunal shall decide the dispute in accordance with the provisions of this Agreement, the terms of other Agreements concluded between the parties, the law of the

dispute was the construction of a chemical plant. The Tribunal did not enter into a theoretical discussion on the law applicable to the case before it. It applied international law to some questions and host State law to other questions before it. For instance, on the issue of whether Spain was responsible for the actions of a State entity the Tribunal relied on the international law of State responsibility for the question of attribution<sup>69</sup> and on the Spanish Law on Public Administration and Common Administrative Procedure to elucidate the structure and functions of the entity.<sup>70</sup> Having reached an affirmative reply on attribution, it then applied the BIT.<sup>71</sup> On the issue of an environmental impact assessment the tribunal applied international law,<sup>72</sup> Spanish legislation,<sup>73</sup> a European Community directive<sup>74</sup> and the BIT.<sup>75</sup> To the question of whether a contract had been perfected between the investor and the State entity the Tribunal applied the Spanish Civil Code and the Spanish Commercial Code together with authoritative commentaries.<sup>76</sup> On the issue of a statute of limitation under Spanish legislation, the Tribunal found that it did not apply to claims filed under the ICSID Convention.<sup>77</sup>

In *Antoine Goetz v. Burundi*<sup>78</sup> the relevant Belgium/Burundi BIT also contained a provision on applicable law that referred to host State law and to international law.<sup>79</sup> The subject-matter of the dispute was the revocation of a free zone regime. The Tribunal found that under the BIT's choice of law rule it had to apply a combination of international law and domestic law.<sup>80</sup> The four categories of sources listed in the BIT could be regrouped into two: the law of Burundi on one hand and international law on the other. The provisions of the BIT were part of the applicable rules and principles of international law.<sup>81</sup> After summarizing the

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Contracting Party in whose territory the investment was made, including its rules on conflict of laws, and general principles of international law.

<sup>69</sup> At paras. 50, 52, 57, 77, 83.

<sup>70</sup> At paras. 47-49.

<sup>71</sup> At para. 83.

<sup>72</sup> At para. 67.

<sup>73</sup> At paras. 68, 69.

<sup>74</sup> At para. 69.

<sup>75</sup> At para. 71.

<sup>76</sup> At paras. 89, 90.

<sup>77</sup> At paras. 92, 93.

<sup>78</sup> *Antoine Goetz v. Burundi*, Award, 10 February 1999, 6 ICSID Reports 3.

<sup>79</sup> Belgium/Burundi BIT, Article 8(5): The arbitral body decides on the basis of: the domestic law of the contracting party to the dispute, on the territory of which the investment is located, including its rules relating to the conflict of laws; the provisions of the present Treaty; the terms of the particular agreement which might have taken place regarding the investment; the generally accepted rules and principles of international law.

<sup>80</sup> At para. 95.

<sup>81</sup> At para. 96.

practice under the second sentence of Article 42(1) of the ICSID Convention,<sup>82</sup> the Tribunal made the following general statement:

In the present case – which relates, it must be recalled, to the first sentence of Article 42 of the ICSID Convention – a complementary relationship must be allowed to prevail. That the Tribunal must apply Burundian law is beyond doubt, since this last is also cited in the first place by the relevant provision of the Belgium-Burundi investment treaty. As regards international law, its application is obligatory for two reasons. First, because, according to the indications furnished to the Tribunal by the claimants, Burundian law seems to incorporate international law and thus to render it directly applicable; ... Furthermore, because the Republic of Burundi is bound by the international law obligations which it freely assumed under the Treaty for the protection of investments, ...<sup>83</sup>

The Tribunal then stated that an application of international law and of domestic law might lead to different results. In such a situation, under the applicable BIT, investors were entitled to invoke the provision most favourable to them.<sup>84</sup> The Tribunal then proceeded to apply a two-pronged approach: it first undertook an analysis of the dispute from the perspective of the law of Burundi. This analysis led to the conclusion that under the law of Burundi the actions in question were not illegal and, consequently, the State had not incurred responsibility.<sup>85</sup> Having reached this result, the Tribunal then examined the same issue from the perspective of international law, in particular in light of the BIT. This examination led to the result that the legality of the measures taken by Burundi depended on the payment of an adequate and effective indemnity which was still outstanding.<sup>86</sup>

The method applied by the *Goetz* Tribunal is strongly reminiscent of the approach developed by Tribunals under the second sentence of Article 42(1). Under that method, where host State law and international law are to be applied, international law would have a corrective role vis-à-vis domestic law. But it is possible that the decisive element in the application of the “corrective method” was the BIT’s provision directing the Tribunal to give priority to the more favourable provisions, national or international.

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<sup>82</sup> At para. 97.

<sup>83</sup> At para. 98.

<sup>84</sup> At para. 99. Article 7(2) of the Belgium/Burundi BIT provides: When a question relating to an investment is governed both by the present treaty and by one or other of the provisions referred to in Paragraph 1, the investor can always assert the provisions which are more favourable to them.

<sup>85</sup> At paras. 100-119.

<sup>86</sup> At paras. 120-133.

On balance, the flexible or issue specific approach employed by the *Maffezini* Tribunal appears more convincing than the doctrinaire approach applied in the majority of cases decided under Article 42 of the ICSID Convention. The doctrinaire approach tries to create a fixed relationship between the two systems of law. It assigns a particular role to international law in relation to host state law: to supplement it in case of gaps and to correct it in case of any contradiction between the two systems of law. By contrast, the issue specific approach identifies questions that arise before the tribunal in their proper legal context. It will apply host State law where the issue is one of domestic law such as the validity of a contract. It will apply international law where appropriate, for instance where the issue is one of treaty interpretation or of State responsibility.

The ad hoc Committee in *Vivendi* described this process in the following terms:

... whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract, in other words, the law of Tucumán.<sup>87</sup>

This leaves the tribunal with the task of identifying the questions to be answered by reference to one or the other system of law. The *Wena ad hoc* Committee<sup>88</sup> and *Gaillard/Banifatemi*<sup>89</sup> have pointed to the tribunal's margin for interpretation or discretion in this context. The Svea Court of Appeal in *Czech Republic v. CME Czech Republic B.V.*<sup>90</sup>, also emphasized the tribunal's discretion. The Tribunal, despite being directed to apply host State law and international law,<sup>91</sup> had declined to apply Czech law. The Applicant sought to have the award set aside, *inter alia*, for failure to apply the proper law. The Svea Court declined to set aside the award. It held that "it is sufficient to clarify whether the arbitral tribunal applied any of

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<sup>87</sup> *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic (Vivendi)*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, para. 96.

<sup>88</sup> *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, 6 ICSID Reports 129, 138, para. 39.

<sup>89</sup> *E. Gaillard/Y. Banifatemi*, The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process, 18 ICSID Review 375, 409, 410.

<sup>90</sup> *Czech Republic v. CME Czech Republic B.V.*, Svea Court of Appeals, Judgment of 15 May 2003, 42 ILM 919 (2003).

<sup>91</sup> Article 8.6 of the Czech/Netherlands BIT provides: The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively: the law in force of the Contracting Party concerned; the provisions of this Agreement, and other relevant Agreements between the Contracting Parties; the provisions of special agreements relating to the investment; the general principles of international law.

the sources of law listed in the choice of law clause or whether the tribunal has not based its decision on any law at all...”<sup>92</sup>

Is the tribunal’s discretion really the last word on this question? Is it not incumbent upon the tribunal to identify those issues that must be resolved in accordance with international law and those that are governed by domestic law? In many cases this task will be easy. Questions relating to a contract or to the host State’s public administration will be answered by reference to domestic law. Questions regulated by customary international law or by treaty law will be answered by reference to international law.

For instance, if the investor claims that by virtue of first a breach and then the termination of a contract there has been a violation of the fair and equitable principle and the rules on indirect expropriation in a BIT, both systems of law will be relevant. Host State law will determine whether there ever was a valid contract, whether it had been breached and whether the termination was lawful and effective under domestic law. International law will determine whether the damaging acts were attributable to the host State, whether they were unfair and inequitable and whether they constituted an illicit indirect expropriation.

But this model is unlikely to resolve all problems of qualification. In some situations there may well be an overlap and it is not impossible that one and the same question is covered by both domestic and international law. The calculation of interest is a good example. In *Wena Hotels v. Egypt*<sup>93</sup> the Tribunal, on the basis of international law authority, had awarded interest at 9% compounded quarterly. Egypt challenged the calculation as being contrary to Egyptian law which contains various limits to the determination of interest. Egyptian law and international law were applicable by virtue of Article 42(1), second sentence of the ICSID Convention.

The *ad hoc* Committee in *Wena* found that the calculation of interest adopted by the Tribunal was covered, by implication, by the BIT’s provisions on full compensation.<sup>94</sup> But it did not explain why the BIT took precedence over Egyptian law on this point except to state that the BIT was part of Egypt’s legal system.<sup>95</sup> There was no provision in the BIT guaranteeing the

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<sup>92</sup> 42 ILM 965 (2003).

<sup>93</sup> *Wena Hotels v. Egypt*, Award, 8 December 2000, 6 ICSID Reports 89, paras. 128, 129.

<sup>94</sup> *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, 6 ICSID Reports 129, paras. 51, 52.

<sup>95</sup> At paras. 42-46.

investor the more favourable treatment of domestic or international law. Did international law apply in its “corrective function”? It is difficult to argue that the limits to the determination of interest in Egyptian law are contrary to international law in general terms. Perhaps a conflict between the BIT clause on full compensation and the limiting provisions in Egyptian law can be construed.

This leads to the conclusion that when faced with a combined choice of law, pointing to international law and host State law, the tribunal’s first task is to identify which of the questions before it are governed by international law and which are governed by domestic law. Only in the relatively rare situation where both systems of law provide answers which genuinely contradict each other will there be an opportunity to give precedence to one or the other, normally to international law in its “corrective function”.

Reliance on the tribunal’s discretion in selecting the applicable law leads to another problem. If the array of sources of law is very broad the question arises whether it is possible to speak of a genuine choice of law by the parties. If the tribunal has been directed to apply the host State’s law, a BIT and other treaties, any contract relating to the investment and general international law, the choice is so wide that it is difficult to envisage any rules of law that the tribunal may not apply. The tribunal’s discretion to select freely from the menu of all these sources, à la carte as it were, really contradicts the notion of a choice of law by the parties.

In particular, does the tribunal’s discretion include the power to ignore some parts of the menu of applicable sources of law? If the tribunal, in its discretion can go to international law directly, bypassing the host State’s law, is the reverse also true? The logical conclusion would be that the tribunal, in its discretion, may also bypass an applicable BIT – an obviously unacceptable result.

This leaves the question of the interaction of international law and domestic law in cases in which there is no choice of law that refers to both systems. As pointed out above, a choice of the host State’s law alone is rare but not unknown. In such a situation international law may be applicable as part of the chosen domestic law. But reliance on the uncertainties of a particular domestic law in its treatment of international law would not be a satisfactory standard for an international tribunal. For instance, it would be difficult for an international tribunal to ignore the principle that a State may not rely on its domestic law to defeat an

obligation arising from international law. Tribunals have, in fact, indicated that international law is not excluded by a choice of the host State's domestic law.<sup>96</sup>

The exclusion of international law through a choice of a particular domestic law cannot be presumed. Doing so would lead to the untenable consequence that an investor, by agreeing to the application of the host State's law, waives the minimum standards of international law. International standards for the protection of foreign investors are preserved even in the face of a choice of the host State's law. The mandatory rules of international law which provide an international minimum standard for the protection of aliens, exist independently of any choice of law made for a specific transaction. They constitute a framework of public order within which such transactions operate. Their obligatory nature is not open to the disposition of the parties.<sup>97</sup>

Equally, a choice of international law cannot exclude considerations of domestic law entirely. The protection of property through an investment treaty or general international law is contingent upon the existence and extent of property rights as determined by the applicable domestic law.<sup>98</sup> Similarly, if an investor claims that its rights, arising from a contract, have been expropriated or have been subjected to treatment that is contrary to a treaty's fair and equitable standards, domestic law will also be relevant. It will be necessary to look at the existence of the contract and the rights arising under it in terms of the applicable domestic law. Only after clarifying these preliminary issues under domestic law is it possible to determine whether a breach of the international standards has actually occurred.<sup>99</sup>

## Summary

International arbitration of investment disputes lies at the borderline of international and domestic law. This hybrid nature of investment arbitration is evident in a number of ways:

1. The participants in the proceedings are a State and a private investor.
2. Investment arbitration replaces diplomatic protection and litigation in domestic courts.

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<sup>96</sup> *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 358, 372; *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 207-208.

<sup>97</sup> For more detailed discussion see *C. Schreuer*, *The ICSID Convention: A Commentary*, pp. 585-590 (2001).

<sup>98</sup> For detailed discussion see *Z. Douglas*, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 *The British Year Book of International Law* 151, 197 (2003).

<sup>99</sup> See *S. Alexandrov*, *Breaches of Contract and Breaches of Treaty*, 5 *The Journal of World Investment & Trade* 555, 562 (2004) (see especially footnote 43 with references to pertinent practice of the International Court of Justice). See also *MTD v. Chile*, Award, 25 May 2004, 44 ILM 91 (2005), at para. 204.

3. Jurisdiction is often based on an offer to arbitrate contained in a treaty between the host State and the investor's home State. The investor's acceptance of the offer perfects the arbitration agreement between the parties. The interpretation of the consent agreement may combine elements of treaty interpretation and of domestic law.

4. In investment arbitration the claimant will typically argue violations of international law, especially of a BIT or other relevant treaty. Under certain circumstances, claims based on breach of contract may also be pursued. The distinction between the two types of claims is particularly important where a contract contains a domestic forum selection clause.

5. The relevant substantive law in an investment dispute nearly always combines international law and host State law. Some clauses on applicable law refer exclusively to international law. For instance, Article 1131 NAFTA provides:

1. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.

Similar provisions are contained in Art. 26(6) of the Energy Charter Treaty and in some BITs.

Other provisions on applicable law refer to a combination of international law and host State law. Article 42(1) of the ICSID Convention is an example for this:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

The prevailing theory on the meaning of this provision is the doctrine of the primary application of host State law and the supplemental and corrective function of international law. But this theory has practical and theoretical shortcomings and has come under criticism.

Clauses on choice of law in some BITs also combine host State law and international law. A typical formula refers tribunals to:

- a) the host State's law, b) the BIT itself together with other treaties,
- c) any contract relating to the investment and d) general international law.

Tribunals applying these clauses have usually relied on international as well as domestic law.

The most plausible approach consists in identifying the various issues before the tribunal in their proper legal context. The tribunal will then apply international law to some of these issues and domestic law to other issues. Tribunals applying combined choice of law clauses do not have complete discretion in selecting among the sources of law offered to them. Rather, they are bound to identify the issues to which the respective sources apply.

Even in the absence of choice of law clauses referring to both host State law and international law, there will always be a residual role for both systems of law. International law remains applicable in offering a set of minimum standards that form part of a framework of public order. Domestic law remains relevant in defining the rights that are protected by international standards.