

THE ICSID CONVENTION: A COMMENTARY

A Commentary on the Convention on the Settlement of Investment
Disputes between States and Nationals of Other States

SECOND EDITION

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with

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Article 42

(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.

(2) The Tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.

(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.

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I. INTRODUCTION

A. Purpose

- 1 The Convention does not provide substantive rules for the relationship between host States and foreign investors. It is merely designed to establish a procedural framework for the settlement of investment disputes. Suggestions, made in the course of the Convention's drafting, to offer some substantive guidance to tribunals (History, Vol. II, pp. 418 *et seq.*) were not pursued (at pp. 465, 472, 570). Doing so would have led to insurmountable difficulties in trying to reconcile sharply conflicting positions and would have endangered the entire project. At the same time, it was considered necessary to offer some legal security and predictability concerning the outcome of arbitration proceedings.
- 2 Art. 42 provides a mechanism whereby the tribunal is to select the appropriate rules of law for the particular dispute. It is designed to combine flexibility with certainty. Flexibility by granting maximum autonomy to the parties in choosing rules, certainty by ensuring that the tribunal will find appropriate rules even in the absence of such a choice. The aim of flexibility is served by the first sentence of para. (1), on agreement by the parties, and by para. (3), extending party autonomy to equitable principles. The aim of certainty is served by the second sentence of para. (1), designating the host State's law in conjunction with international law as the applicable law in the absence of agreement, and by para. (2), prohibiting a finding of *non liquet* by the tribunal.

B. The Law Applicable to Procedure, Jurisdiction and Nationality

- 3 Art. 42 addresses only the substantive law to be applied, not procedure.¹ Art. 44 of the Convention unequivocally provides that arbitration proceedings are regulated exhaustively by the Convention itself and by the rules adopted under it subject to any agreement by the parties. In the absence of guidance within the

¹ *Hirsch*, The Arbitration Mechanism, p. 110; *Goldman*, Le droit applicable, pp. 138 *et seq.*

Convention's system, the tribunal is to decide any procedural question independently of outside regulations² (see Art. 44, para. 3).

Similarly, Art. 42 does not govern questions of the tribunal's jurisdiction under Art. 25 (see also paras. 154–156 *infra*). In *SPP v. Egypt*, jurisdiction was based on a provision of Egyptian law (see Art. 25, paras. 400–404). Egypt contended that the jurisdictional issues were governed by Egyptian law by virtue of Art. 42(1). This would have led to the application of sections 501 and 502 of the Egyptian Code of Civil Procedure, which require a specific and independent *compromis* or a special agreement for arbitration. Since these requirements had not been fulfilled, this argument would have led to a denial of the ICSID tribunal's jurisdiction.³ The Claimants' contention that the provision of municipal law providing for ICSID jurisdiction should be treated as a mere fact or should be construed in accordance with the rules of treaty interpretation did not find favour with the Tribunal. Still, the Tribunal rejected Egypt's argument that its own interpretation of an ICSID clause in its legislation was controlling. Instead, it pointed out that the statutory provision, which SPP claimed to be a unilateral acceptance of the Centre's jurisdiction, would have to be considered in light of the international law governing unilateral juridical acts.⁴ After referring to decisions of the Permanent Court of International Justice and of the International Court of Justice on unilateral consent to jurisdiction, the Tribunal concluded:

... 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.⁵

In *CSOB v. Slovakia*, jurisdiction was based on an agreement between the parties (see Art. 25, para. 390). The Tribunal held:

35. 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.⁶

In *Siemens v. Argentina*, the Tribunal had to assess its treaty-based jurisdiction. It rejected Argentina's argument that the provision on applicable law in the Argentina/Germany BIT governed questions of jurisdiction:

31. Argentina in its allegations has not distinguished between the law applicable to the merits of the dispute and the law applicable to determine the Tribunal's jurisdiction. This being an ICSID Tribunal, its jurisdiction is governed by Article 25 of the ICSID Convention and the terms of the instrument expressing the parties' consent to ICSID arbitration, namely, Article 10 of the Treaty.

² See *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 357.

³ See also a similar argument in *SOABI v. Senegal*, Award, 25 February 1988, paras. 4.54, 4.55.

⁴ *SPP v. Egypt*, Decision on Jurisdiction II, 14 April 1988, paras. 55 *et seq.*

⁵ At para. 61. *Cf.* also the Dissenting Opinion to this decision at 3 ICSID Reports 170, 177 and 186.

⁶ *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, para. 35.

Therefore, the Tribunal needs to assess whether the Request for Arbitration meets the requirements of Article 25 of the ICSID Convention and of Article 10 of the Treaty.⁷

- 7 The prevailing view, that Art. 42 does not address questions of jurisdiction, was reaffirmed in the Decision on Jurisdiction in *CMS v. Argentina*.⁸ The Tribunal held:

88. Article 42 is mainly designed for the resolution of disputes on the merits and, as such, it is in principle independent from the decisions on jurisdiction, governed solely by Article 25 of the Convention and those other provisions of the consent instrument which might be applicable, in the instant case the Treaty provisions. However, the argument of the Republic of Argentina has merit in so far as the parties can agree to a different choice of law applicable also to jurisdictional questions. The very option the investor has under the Treaty to submit a dispute to local jurisdiction also involves to an extent a choice of law provision, as local courts will apply mainly domestic law. In such a case, domestic law might apply together with the Treaty and Convention or separately.⁹

- 8 Other tribunals have confirmed that the law applicable to the tribunal's jurisdiction were the provisions of the BIT and Art. 25.¹⁰ A minority of tribunals have recognized a role for the host State's domestic law in determining jurisdiction.¹¹

- 9 Another issue that is not governed by the rule of Art. 42 is the nationality of the investor. The nationality of a natural person is determined primarily by the law of the State whose nationality is claimed (see Art. 25, paras. 641–647). In *Soufraki v. UAE* the Tribunal reaffirmed the primary relevance of the law of the State whose nationality is claimed. The Tribunal also emphasized that it had jurisdiction to scrutinize whether the nationality requirements under domestic law were fulfilled:

55. It is accepted in international law that nationality is within the domestic jurisdiction of the State, which settles, by its own legislation, the rules relating to the acquisition (and loss) of its nationality. Article 1(3) of the BIT reflects this rule. But it is no less accepted that when, in international arbitral or judicial proceedings, the nationality of a person is challenged, the international tribunal is competent to pass upon that challenge. It will accord great weight to the

7 *Siemens v. Argentina*, Decision on Jurisdiction, 3 August 2004, para. 31; see also *Azurix v. Argentina*, Decision on Jurisdiction, 8 December 2003, paras. 48–50.

8 *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, paras. 42, 87–89.

9 At para. 88. To the same effect: *CMS v. Argentina*, Decision on Annulment, 25 September 2007, para. 68.

10 *Enron v. Argentina*, Decision on Jurisdiction, 14 January 2004, para. 38; *AES v. Argentina*, Decision on Jurisdiction, 26 April 2005, paras. 34–39; *Camuzzi v. Argentina I*, Decision on Jurisdiction, 11 May 2005, paras. 15–17, 57; *Sempra v. Argentina*, Decision on Jurisdiction, 11 May 2005, paras. 25–28; *Jan de Nul v. Egypt*, Decision on Jurisdiction, 16 June 2006, paras. 65–68; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, paras. 68–70, 78–82; *Noble Energy v. Ecuador*, Decision on Jurisdiction, 5 March 2008, paras. 56, 57.

11 *Zhinvali v. Georgia*, Award, 24 January 2003, paras. 296–301, 339; *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 131, 222–264.

nationality law of the State in question and to the interpretation and application of that law by its authorities. But it will in the end decide for itself whether, on the facts and law before it, the person whose nationality is at issue was or was not a national of the State in question and when, and what follows from that finding. [...]¹²

The nationality of a juridical person is determined by the criteria of incorporation or seat of the company in question subject to pertinent agreements, treaties and legislation (see Art. 25, paras. 694–740). This view was expressly endorsed by the decision on jurisdiction in *AES v. Argentina* which rejected the assertion of the host State that Art. 42 would be applicable to issues on nationality.¹³ The law of the investor’s nationality also governs the investor’s status and legal capacity (see paras. 157–159 *infra*). **10**

An issue related to nationality is the problem of *jus standi*, in particular of minority shareholders, to submit claims to ICSID. It is not governed by Art. 42. Rather, it is determined according to the applicable international investment agreements and Art. 25 (see Art. 25, para. 150). In the Decision on Preliminary Objections in *Pan American v. Argentina*, the Tribunal rejected the host State’s view that the law applicable to the merits would also determine the existence of *jus standi* for the Claimants.¹⁴ Instead, it found that **11**

the instant case is not situated at the level of general international law but at that of treaty law – the BIT and the ICSID Convention – and the Claimants have established that the applicable Treaty deviates from *Barcelona Traction*, allowing, *inter alia*, claims based on direct or indirect shareholdings of nationals of one Contracting State in companies of another Contracting State.¹⁵

The same solution was reached in the Decision on Jurisdiction in the case of *CMS v. Argentina*. Argentina had challenged the ability of minority shareholders to institute ICSID proceedings on the basis of domestic law provisions “in that country, as in most civil and common law countries, to the effect that the corporate legal personality is distinct and separate from that of the shareholders”.¹⁶ The *CMS* Tribunal, however, did not consider this legal distinction of Argentinian law “determinant” because it found that “the applicable jurisdictional provisions are only those of the Convention and the BIT, not those which might arise from national legislation”.¹⁷ **12**

¹² *Soufraki v. UAE*, Award, 7 July 2004, para. 55. See also *Champion Trading v. Egypt*, Decision on Jurisdiction, 21 October 2003, sec. 3.4.1; *Siag v. Egypt*, Decision on Jurisdiction, 11 April 2007, paras. 195–201; *Micula v. Romania*, Decision on Jurisdiction, 24 September 2008, paras. 86, 101.

¹³ *AES v. Argentina*, Decision on Jurisdiction, 26 April 2005, para. 78, citing the First Edition of this Commentary.

¹⁴ *Pan American v. Argentina*, Decision on Preliminary Objections, 27 July 2006, paras. 192–193. At para. 217.

¹⁶ *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 42.

¹⁷ *Loc. cit.* This finding was explicitly endorsed by the *ad hoc* Committee: *CMS v. Argentina*, Decision on Annulment, 25 September 2007, para. 68.

C. Methodology

- 13 A municipal court having to decide which system of law is applicable to a dispute is guided by the rules of private international law of the *lex fori*. The *lex fori* containing conflict of laws rules in the case of ICSID arbitration is Art. 42. Art. 42 is designed to give guidance to the ICSID tribunal in choosing the proper law. The tribunal's first task is to ascertain whether the parties have chosen a system of law or individual rules of law (Art. 42(1), first sentence). This choice may extend beyond legal rules *stricto sensu* to principles of equitable justice (Art. 42(3)). Only after determining that there is no agreement on applicable rules of law may the tribunal resort to the residual rule referring it to the law of the host State and to international law (Art. 42(1), second sentence).¹⁸ This method should provide the tribunal with sufficient authority to resolve all questions of law before it and should leave no room for silence or obscurity of the law making a decision impossible (Art. 42(2)). Despite the apparent clarity of Art. 42, ICSID tribunals have not always followed the method set out there. In particular, whether an agreement between the parties existed was not always clarified. At times, such a determination was considered immaterial to applying the proper law (see paras. 65–67 *infra*). At other times, the line between the different situations envisaged in Art. 42 appears to have been blurred.

D. Proper Law and Nullity

- 14 The risks of applying Art. 42 carelessly are well illustrated by the possible consequence of nullity of the resulting award¹⁹ (see also Art. 52, paras. 191–270). During the drafting of what eventually became Art. 52 on annulment, a suggestion was made to add to the clause on excess of powers (Art. 52(1)(b)) the words “including failure to apply the proper law” (History, Vol. II, p. 517). The suggestion was not adopted. But the Chairman expressed the opinion that while a mistake in applying the law would not be a valid ground for annulment, applying a different law from that agreed by the parties would lead to an award that could be properly challenged on the ground that the arbitrators had gone against the terms of the *compromis* (at p. 518).
- 15 In *Klöckner v. Cameroon*, the *ad hoc* Committee confirmed that an excess of powers leading to nullity may consist in the non-application of the rules contained in the arbitration agreement or in the application of other rules.²⁰ It

18 *Delaume, G. R.*, The Pyramids Stand – The Pharaohs Can Rest in Peace, 8 ICSID Review – FILJ 231 at 241/2 (1993); *Delaume*, L'affaire, pp. 41, 47; *Begic*, Applicable Law in International Investment Disputes, p. 11.

19 See also *Shihata/Parra*, Applicable Substantive Law, pp. 206 *et seq.*; *Lauterpacht, E.*, Aspects of the Administration of International Justice 102 *et seq.* (1991); *Giardina, A.*, ICSID: A Self-Contained, Non-National Review System, *in*: International Arbitration in the 21st Century: Towards “Judicialization” and Uniformity? (*Lillich, R. B./Brower, C. N.* eds.) 199 at 211 (1994); *Reisman*, The Regime for *Lacunae*, p. 380; *Kreindler, R.*, The Law Applicable to International Investment Disputes, p. 422.

20 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 59.

adopted the distinction between a non-application of the governing law and a mistaken application of such law, holding that a mere error in law, even an essential one, would not generally constitute an excess of powers.²¹ The *ad hoc* Committee found that in the instant case the Tribunal, after having identified the applicable law correctly,²² had not, in fact, applied it but had based its decision on a broad equitable principle without establishing its existence in positive law. No attempt had been made to show that Cameroonian law, based on French law, contained a “duty of full disclosure to a partner” in a contract.²³ In the *ad hoc* Committee’s opinion, the award’s reasoning seemed very much like a simple reference to equity. By limiting its reasoning to postulating rather than demonstrating the existence of the principle, the Tribunal had not applied the law of the Contracting State.²⁴ In applying concepts or principles it probably considered equitable, the Tribunal had acted outside the framework of Art. 42(1) and had thus manifestly exceeded its powers in the sense of Art. 52(1)(b) (see paras. 262, 263 *infra*).²⁵

In the Decision on Annulment in *Amco v. Indonesia*, the *ad hoc* Committee reiterated the distinction between a failure to apply the proper law and a mere misconstruction of that law and pointed out that only the former would constitute a manifest excess of powers and a ground for nullity under Art. 52(1)(b).²⁶ Also, in the *ad hoc* Committee’s view, the invocation of equitable considerations was not automatically equivalent to a decision *ex aequo et bono* which, in the absence of an agreement by the parties in accordance with Art. 42(3), would render a decision annulable for manifest excess of powers (see paras. 269–271 *infra*).²⁷ In this case too, the complaint was not that the Tribunal had erred in selecting the proper law²⁸ but rather that it had failed to apply an essential provision of the correctly chosen applicable law. In calculating Amco’s investments in Indonesia, the Tribunal had ignored a rule of Indonesian law that only investments recognized and registered as such by the competent Indonesian authority were to be considered investments. By failing to apply this fundamental provision of Indonesian law, the Tribunal had manifestly exceeded its powers. The relevant portion of the Award, therefore, had to be annulled.²⁹

In *MINE v. Guinea*, the *ad hoc* Committee confirmed the view that disregard of the agreed rules of law would constitute a derogation from a tribunal’s terms of reference and could hence constitute an excess of powers. This would include a

21 At para. 61.

22 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 58/9.

23 At p. 59.

24 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 79 (see also paras. 150, 151 *infra*).

25 *Loc. cit.*

26 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 23.

27 At paras. 26, 28.

28 See *Amco v. Indonesia*, Award, 20 November 1984.

29 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, paras. 93–105.

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decision not based on any law unless the parties had agreed on a decision *ex aequo et bono*. It also distinguished disregard of the applicable rules of law from a mere erroneous application, which furnishes no ground for annulment.³⁰ Guinea had put forward the argument that in ruling on the point of breach of contract the Tribunal had “failed to apply any law whatsoever, much less the correct law – Guinean law, based on French law”.³¹ The *ad hoc* Committee rejected this contention. MINE had based its case on Art. 1134 of the Code Civil de l’Union Française applicable in Guinea and containing the principles of *pacta sunt servanda* and good faith. The Tribunal had erred in that it had cited Art. 1134 of the French Civil Code.³² The *ad hoc* Committee noted that the two Articles in the two Codes not only bore the same number but also had the same contents and that this error did not warrant annulment.³³

- 18 Despite the distinction they made between a non-application of the proper law and its mere misapplication, the *Klöckner* and *Amco ad hoc* Committees applied extremely strict standards to the Awards before them. There was no question of an incorrect choice of law in either case. In *Klöckner* the Tribunal had failed to substantiate the rule it applied in terms of the relevant legislation and court practice. In *Amco*, the Tribunal had failed to take account of a procedural rule of the applicable law which would have led it to disregard investments which had, in fact, been made. The two *ad hoc* Committees’ reasoning blurs the boundary between an error in the interpretation or application of the governing law and a failure to apply the applicable law. In this way, the distinction between an incorrect choice of law and a misapplication of the correctly chosen law becomes tenuous.
- 19 No matter how justified the annulments in *Klöckner* and *Amco* were in terms of a failure to apply the proper law, the fact remains that a violation of Art. 42 may lead to the annulment of an award. The preparatory works (see para. 14 *supra*) as well as the decisions of the *ad hoc* Committees referred to above leave no doubt that an agreement on choice of law is an essential element of the parties’ undertaking to arbitrate. In the absence of an express agreement on choice of law, the second sentence of Art. 42(1) would equally form part of the tribunal’s “terms of reference”. Its violation would therefore also expose the award to annulment.³⁴
- 20 Subsequent *ad hoc* committees have confirmed that a non-application of the proper law may constitute an excess of powers which calls for annulment. At the same time, the committees stressed the distinction between a mere misapplication

30 *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 5.04.

31 At para. 6.30.

32 See *MINE v. Guinea*, Award, 6 January 1988, 4 ICSID Reports 73.

33 *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 6.40. A similar argument on “failure to apply the law” in the context of the award of damages was not dealt with by the *ad hoc* Committee, at paras. 6.93, 6.109.

34 *Shihata/Parra*, Applicable Substantive Law, p. 207.

of the properly selected law and an error of such magnitude as to amount to a non-application of the proper law.³⁵ The relevant cases are examined in more detail in the context of the provision of Art. 52 on manifest excess of powers (see Art. 52, paras. 210–225).

II. INTERPRETATION

A. “(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties.”

1. Freedom of Choice

Art. 42(1) proceeds from the basic freedom of the parties to choose the law they consider most appropriate for their relationship.³⁶ This freedom of choice is a recurrent theme in the *travaux préparatoires* (History, Vol. II, pp. 266/7, 330, 514, 569/70, 984), although misgivings were aired that this might be exploited to the advantage of the foreign investor (at p. 803). The parties are free to avail themselves of the option offered by Art. 42(1), first sentence, or to leave the question of applicable law to the residual rule of Art. 42(1), second sentence. There are several possible motives for selecting a particular system of law. The parties may be influenced by a desire to create greater certainty, by a preference for a law with which one of them or both is familiar or by the wish to maximize the legal protection for one of them, most notably the foreign investor.³⁷ On the other hand, the law most closely connected to the contractual relationship will presumably be the most practical choice. In addition, the State party to an investment contract may insist on the application of its own domestic law as a matter of principle and of national prestige. 21

2. Modality of Choice

The choice of law open to the parties may be exercised in one of several ways. One is a direct agreement between the parties. The 1993 ICSID Model Clauses offer the following sample for an agreement on choice of law: 22

³⁵ *Amco v. Indonesia*, Resubmitted Case: Decision on Annulment, 17 December 1992, paras. 7.18–7.29; *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, paras. 21–55; *CDC v. Seychelles*, Decision on Annulment, 29 June 2005, paras. 44–47; *Repsol v. Petroecuador*, Decision on Annulment, 8 January 2007, para. 38; *MTD v. Chile*, Decision on Annulment, 21 March 2007, paras. 44–48, 59–77; *Soufraki v. UAE*, Decision on Annulment, 5 June 2007, paras. 35, 37, 79–114; *Lucchetti v. Peru*, Decision on Annulment, 5 September 2007, para. 98.

³⁶ Generally on the freedom of choice of law see *Lipstein, K.*, *International Arbitration Between Individuals and Governments and the Conflict of Laws*, in: *Contemporary Problems of International Law: Essays in Honour of Georg Schwarzenberger 177* (1988).

³⁷ *Broches, A.*, *Choice-of-Law Provisions in Contracts with Governments*, 26 *The Record of the Association of the Bar of the City of New York* 42, 43 (1971).

Clause 10

Any Arbitral Tribunal constituted pursuant to this agreement shall apply specification of system of law [as in force on the date on which this agreement is signed]/[subject to the following modifications: . . .].³⁸

The explanatory comments to the Model Clauses point out that the parties are free to agree on rules of law defined as they choose. They spell out that they may refer to national law, international law, a combination of national and international law, or a law frozen in time or subject to certain modifications. Earlier versions of the Model Clauses offered specific references to international law³⁹ and a formula for the exclusion of a particular system of law.⁴⁰ Parties have exercised this choice in a number of cases (see paras. 24–37 *infra*). In *Santa Elena v. Costa Rica*, the Tribunal held that an agreement on choice of law would have to be clear and unequivocal.⁴¹

- 23 If jurisdiction is based not on a direct agreement between the parties but on a provision in the host State's law or in a treaty (see Art. 25, paras. 390–463), those instruments may provide for a choice of law prior to the institution of proceedings. Typically, the first direct contact between the parties in these cases is the request for arbitration. But the national legislation or treaty offering consent to jurisdiction may contain its own clause on applicable law. By taking up the offer of consent, the investor accepts the choice of law clause contained in the legislation or treaty. Therefore, the clause on applicable law becomes a choice of law agreed by the parties. A national investment code providing for ICSID arbitration (see Art. 25, paras. 394–426) may specify the law to be applied by the tribunal (see para. 63 *infra*). Some bilateral investment treaties (BITs) offering consent to ICSID jurisdiction (see Art. 25, paras. 427–455) designate the applicable law (see paras. 80, 84 *infra*). Multilateral treaties providing for ICSID's jurisdiction (Art. 25, paras. 456–463) also contain clauses on applicable law (see paras. 85–88 *infra*).

3. The Law Chosen by the Parties

a) The Law of the Host State

- 24 Practice shows considerable variety in the drafting of choice of law clauses.⁴² A straightforward reference to the domestic law of the host State is relatively rare. An example for such a choice of law is contained in the Participation Agreement of 1982 between New Zealand and Mobil Oil NZ Ltd. Art. VII, providing for ICSID arbitration, contains the following formula:

7.7 An Arbitral Tribunal shall apply the Law of New Zealand.⁴³

38 4 ICSID Reports 364.

39 See the 1981 Model Clauses, Clause XVII, 1 ICSID Reports 206.

40 See the 1968 Model Clauses, Clauses XIX–XXI, 7 ILM 1175/6 (1968).

41 *Santa Elena v. Costa Rica*, Award, 17 February 2000, paras. 28, 35, 37, 40, 60–68.

42 For overviews of practice see *Shihata/Parra*, *Applicable Substantive Law*, pp. 198 *et seq.*; *Delaume*, *Le Centre*, pp. 825 *et seq.*; *Delaume*, *L'affaire*, pp. 42 *et seq.*

43 *Attorney-General v. Mobil Oil NZ Ltd.*, New Zealand, High Court, 1 July 1987, 4 ICSID Reports 123.

In *Tanzania Electric v. IPTL*, the Tribunal applied the law of Tanzania “that being the governing law of the contract expressly designated by the parties by Article 19.4 of the [Power Purchase Agreement]”.⁴⁴ 25

A more cautious approach is taken where the law of the host State is chosen subject to a stabilization or intangibility clause designed to protect the contract from subsequent changes in the law (see paras. 117–128 *infra*). This is exemplified by clauses in contracts concluded by Guinea. Thus, *Atlantic Triton v. Guinea* arose from a 1981 contract containing the following clause: 26

Article 14 – Law

The term “law” in the present Agreement refers to Guinean law. However, Guinean law will be applicable only insofar as it is not incompatible with the terms of the present Agreement, and where it is not more restrictive than the law in force at the date of entry into force of the present Agreement.⁴⁵

Similarly, the Agreement of 1971 underlying the case of *MINE v. Guinea* contains the following Art. XIII, para. 1:

La Loi de la présente Convention sera la Loi de la République de Guinée en vigueur à la date de signature, sous réserve des dispositions du présent Article XIII.⁴⁶

b) The Law of a Third State

References to the law of the investor’s home country or to the law of a third State are rare. Where the investment involves extensive activities of the investor in the host State, the choice of a law other than that of the host State would lead to difficulties. The investor’s activities will be so closely linked to the administrative law, labour law, tax law, foreign exchange regulations, real property legislation and many other areas of the host State’s legal system that it would be impractical to choose the law of another country.⁴⁷ But in cases involving loan contracts, there is a well-established practice to submit the agreement to the law of the lender’s country or, less frequently, to the law of a third country which has an important financial centre.⁴⁸ 27

In *SPP v. Egypt*, a loan agreement of 1976 which was supplementary in nature to the parties’ primary agreement provided: 28

This Agreement shall be governed by and construed in all respects in accordance with the laws of England.⁴⁹

⁴⁴ *Tanzania Electric v. IPTL*, Award, 12 July 2001, para. 51, Appendix B, paras. 98 *et seq.*

⁴⁵ *Atlantic Triton v. Guinea*, Award, 21 April 1986, 3 ICSID Reports 23. Interestingly, the subsequent Article containing an ICSID arbitration clause contains a reference to Art. 42(3) of the Convention – see 3 ICSID Reports 17.

⁴⁶ *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 6.31. Subsequent paragraphs guarantee precedence of the Agreement over the law of Guinea (see paras. 37, 38 *infra*).

⁴⁷ *Goldman*, Le droit applicable, p. 155; *Kahn*, The Law Applicable, pp. 12/13.

⁴⁸ *Delaume, G. R.*, ICSID and the Transnational Financial Community, 1 ICSID Review – FILJ 237 at 243 (1986).

⁴⁹ *SPP v. Egypt*, Award, 20 May 1992, para. 225. The choice of English law to the exclusion of Egyptian law turned out to be decisive for the computation of interest.

29 In *CDC v. Seychelles*, an Amending and Rescheduling Agreement to a loan agreement between an English company and the host State provided as follows:

This Agreement and its performance shall be governed by and construed in all respects in accordance with the laws of England . . .

The Tribunal noted that the submissions presented by the parties proceeded on the footing that the claim was to be resolved in accordance with English law.⁵⁰

30 A choice of the law of the investor's home country also seems to have been made in *Colt Industries v. Korea*.⁵¹ The investment concerned technical and licensing agreements for the production of weapons and was apparently most closely connected with the licensor's home country.⁵²

31 In *World Duty Free v. Kenya*, a contract for the construction, maintenance and operation of an airport duty free complex contained two choice of law clauses opting for both English and Kenyan law. Because of the substantial similarity of the two legal systems, the Tribunal did not see any problem in applying this "perhaps awkwardly worded" choice of law:

158. The Tribunal now turns to the applicable laws chosen by the Parties in their Agreement of 27th April 1989, as required by Article 42(1) of the ICSID Convention. As already recorded above, Article 9(2)(c) of this Agreement provides that "any arbitral tribunal constituted pursuant to this Agreement shall apply English law"; and Article 10(A) provides that "This Agreement shall be governed by and construed in accordance with the law of Kenya".

159. As an express choice of applicable law to their contractual relations, these two provisions are perhaps awkwardly worded. For present purposes, however, no practical difficulty arises from their apparent inconsistency. . . . the Tribunal considers the two legal systems to have the same material effect as applied to this case (. . .).⁵³

32 In situations where the application of a law other than that of the host State is feasible and desirable, it is particularly important that the parties avail themselves of the possibility to choose the governing law. In the absence of an explicit choice of law it is not, as might be expected, the law most closely related to the relationship which will be selected by the ICSID tribunal in accordance with general principles of the conflict of laws. Rather, the mechanical rule of Art. 42(1), second sentence, will direct the tribunal to apply the law of the State party to the dispute (together with any applicable international law) no matter how tenuous the connection of the transaction with that law may be. The rules of the State party's conflict of laws may but need not refer to another more appropriate law (see paras. 161–166 *infra*).

c) *International Law*

33 In most situations, a more realistic way to protect the investors' interests against the vagaries of the host State's law is to internationalize their agreement.⁵⁴ This

50 *CDC v. Seychelles*, Award, 17 December 2003, para. 43.

51 This case was settled and discontinued with no published record of the proceedings.

52 See *Shihata/Parra*, Applicable Substantive Law, p. 199.

53 *World Duty Free v. Kenya*, Award, 4 October 2006, paras. 158–159.

54 *Lillich, R. B.*, *The Law Governing Disputes*, p. 61; *Di Pietro*, Applicable Law, p. 238.

is most frequently achieved by a reference to international law or to general principles of law, together with the host State's law. The result is closely akin to the residual rule of Art. 42(1), second sentence.⁵⁵ Some BITs contain combined choice of law clauses of this kind (see paras. 80–84 *infra*). In *AGIP v. Congo*, the choice of law clause read as follows:

The law of the Congo, supplemented if need be by any principles of international law, will be applicable.⁵⁶

In *Kaiser Bauxite v. Jamaica*, the 1969 Agreement between the parties contained a reference to the host State's law and international law supplemented by a stabilization clause: 34

(3) In determining any dispute submitted to arbitration as aforesaid, the Arbitration Tribunal shall apply the law of Jamaica and such rules of international law as may be applicable excluding however any enactments passed or brought into force in Jamaica subsequent to the date of this agreement which may modify or affect the rights of the parties under the Principal Agreement or this Agreement and excluding also any law or rule which could throw doubt upon the authority or ability of the Government to enter into the Principal Agreement and this Agreement.⁵⁷

In *CSOB v. Slovakia*, the Consolidation Agreement (CA), underlying the dispute, contained the following choice of law clause in its Art. 7(4): 35

This agreement shall be governed by the laws of the Czech Republic and the [BIT].

The Tribunal applied a combination of international law and Czech private law. It said:

An implied submission to international law can be seen in Article 7(4) CA where it is stated that the CA shall be governed by the BIT, in addition to the laws of the Czech Republic. In its First Decision on Jurisdiction (No. 55), the Tribunal concluded that by referring to the BIT in Article 7(4) CA, the Parties intended to incorporate the arbitration clause of Article 8 of the BIT into the CA. As the reference to the BIT in Article 7(4) is not limited to this particular provision, such incorporation into the CA is equally pertinent in respect of any other provision of the BIT that may be relevant for the interpretation and application of the CA. Even to the extent the CA is not governed by international law as such, the BIT, as it is incorporated into the CA, has to be interpreted in the context of the legal system under which it has been drafted. Consequently, the incorporation of the BIT includes the rules of international law that are relevant for its interpretation.⁵⁸

55 For examples see *Delaume, G. R.*, State Contracts and Transnational Arbitration, 75 AJIL 784 at 796 *et seq.* (1981); *Delaume, G. R.*, Transnational Contracts, Applicable Law and Settlement of Disputes (1990), Ch. XV, p. 64; *Delaume, Le Centre*, pp. 825 *et seq.*; *Delaume, G. R.*, How to Draft an ICSID Arbitration Clause, 7 ICSID Review – FILJ 168 at 184/5 (1992); *Delaume, L'affaire*, p. 50; *Firth*, The Law Governing Contracts, pp. 267 *et seq.*; *Kahn*, The Law Applicable, pp. 15 *et seq.*; *Lalive, P.*, L'Etat en tant que partie à des contrats de concession ou d'investissement conclus avec des sociétés privées étrangères, in: 1 New Directions in International Trade Law (UNIDROIT) 317 at 332 *et seq.* (1977).

56 Art. 15 of the Agreement of 2 January 1974, *AGIP v. Congo*, Award, 30 November 1979, para. 18. This provision was supplemented by stabilization clauses contained in separate Articles.

57 *Kaiser Bauxite v. Jamaica*, Decision on Jurisdiction, 6 July 1975, para. 12.

58 *CSOB v. Slovakia*, Award, 29 December 2004, para. 63.

The Tribunal added that the substance of the dispute, which involved a guarantee by the Czech and Slovak governments to cover losses from the privatization of the Claimant, was governed by Czech private law.⁵⁹

- 36 It is possible to completely internationalize a contract by referring exclusively to international law, to general principles of law or to a set of usages customarily governing like transactions.⁶⁰ But this is not advisable. The contacts of the investment activity to various technical provisions of the host State's law (see para. 27 *supra*) would make such a formula impractical. The law thus chosen may lack the clarity and the technical detail that is desirable.⁶¹ But several multilateral treaties providing for ICSID arbitration, including NAFTA and the Energy Charter Treaty, contain clauses on applicable law that refer only to the respective treaty and to rules of international law (see paras. 85–87 *infra*).

d) *The Law of the Contract*

- 37 A doubtful method to select rules applicable to the parties' relationship is to treat the agreement as a self-contained legal system detached from any existing domestic or international law. The choice of law provision in the 1971 Agreement underlying the case *MINE v. Guinea* goes a long way towards reducing the impact of domestic law but stops short of making the agreement a “*contrat sans loi*”:

la Loi Guinéenne n'interviendra dans l'interprétation et l'exécution de la présente Convention qu'à titre supplétif et seulement dans le cas où celle-ci laisserait une difficulté sans solution.⁶²

- 38 A genuine detachment of an agreement from any pre-existing and extraneous system of law is not only questionable on theoretical grounds but may also create practical problems.⁶³ In terms of Art. 42(1), there is no compelling reason why

59 At paras. 71–72.

60 On the general problem of a “*lex mercatoria*” as the applicable law in international arbitration, see *Delaume, G. R.*, The Proper Law of State Contracts and the *Lex Mercatoria*: A Reappraisal, 3 ICSID Review – FILJ 79 (1988); *Giardina*, La legge regolatrice, pp. 682/3; *Goldman*, Le droit applicable, p. 145; *Kahn*, The Law Applicable, p. 18; *Klein, F.-E.*, The Law to be Applied by the Arbitrators to the Substance of the Dispute, in: *The Art of Arbitration: Essays on International Arbitration*. Liber Amicorum Pieter Sanders 189 at 196 *et seq.* (1982); *Lalive, P.*, L'Etat en tant que partie à des contrats de concession ou d'investissement conclus avec des sociétés privées étrangères, in: 1 New Directions in International Trade Law (*UNIDROIT*) 317 at 324/5 (1977); *Gaillard, E.*, Thirty Years of *Lex Mercatoria*: Towards the Selective Application of Transnational Rules, 10 ICSID Review – FILJ 208 (1995).

61 *Sutherland, P. F.*, The World Bank Convention on the Settlement of Investment Disputes, 28 International and Comparative Law Quarterly 367 at 394 (1979); *Lalive, op. cit.*, pp. 335/6 (1977). For a contrary view see *Curtis*, The Legal Security of Economic Development Agreements, pp. 341 *et seq.*

62 Art. XIII, para. 4, cited in *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 6.34. *Cf.* also *Delaume*, Le Centre, p. 827.

63 See esp. *Curtis*, The Legal Security of Economic Development Agreements, p. 340; *Delaume, G. R.*, Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1 International Lawyer 64 at 77 (1966); *Goldman*, Le droit applicable, pp. 146/7; *Hirsch*, The Arbitration Mechanism, pp. 119/20; *Kahn*, The Law Applicable, pp. 14 *et seq.*; *Lalive, op. cit.*, p. 335; *Peter, W.*, Arbitration and Renegotiation of International Investment Agreements 91 *et seq.* (1986).

the “rules of law as may be agreed by the parties” cannot be confined to the rules contained in their agreement. However, if a tribunal can find no guidance on a particular question in the agreement itself, it may resort to the second sentence of Art. 42(1). In view of the clear prohibition of a *non liquet* in Art. 42(2), an agreement to apply a set of rules that provide no answer to a question may be treated as an absence of agreement on applicable law concerning this particular question (see paras. 135–137 *infra*). Therefore, a choice of law clause couched in terms of an exclusive reference to the terms of the agreement between the parties is not necessarily a promising method to avoid the application of the law of the host State. Alternatively, where the contract is agreed by the parties to be the applicable law, the tribunal may conclude that the parties’ agreement authorizes it, by implication, to fill gaps by recourse to general principles of law or to some other national law.

4. Choice of Law or Choice of Rules

Art. 42(1), first sentence, refers to “rules of law” rather than to systems of law.⁶⁴ Therefore, it is generally accepted that the parties are not restricted to accepting an entire system of law *tel quel* but are free to combine, to select and to exclude rules or sets of rules of different origin.⁶⁵ The parties may want to choose rules of law common to their two countries or indeed to any combination of countries they select.⁶⁶ Alternatively, they may choose certain pieces of legislation from a particular legal system. In *Autopista v. Venezuela*, the Tribunal expressly endorsed this method. It stated:

96. The Tribunal observes that the first sentence of Article 42(1) refers to “rules of law” rather than to systems of law. It is generally accepted that this wording allows the parties to agree on a partial choice of law, and in particular to select specific rules from a system of law.⁶⁷

Not infrequently, choice of law clauses refer to several legal systems cumulatively. For instance, a number of BITs refer to the law of the host State and to international law in a way similar to the residual rule of the second sentence of Art. 42(1) (see paras. 80–84 *infra*). The parties may also subject different parts of

64 Earlier drafts to the Convention referred to “the law to be applied”. The change to “rules of law” was only made relatively late. No reasons for the change are apparent from the *travaux préparatoires*. See History, Vol. I, pp. 190–192.

65 Curtis, The Legal Security of Economic Development Agreements, p. 341; Cherian, Investment Contracts, p. 75; Giardina, A., The International Centre for Settlement of Investment Disputes between States and Nationals of Other States (ICSID), in: Essays on International Commercial Arbitration (Sarcevic, P. ed.) 214 at 216 (1989); Hirsch, The Arbitration Mechanism, pp. 118/9; Lalive, *op. cit.*, pp. 328/30.

66 Shihata/Parra, Applicable Substantive Law, p. 189; Amerasinghe, C. F., Submissions to the Jurisdiction of the International Centre for Settlement of Investment Disputes, 5 Journal of Maritime Law and Commerce 211, 238/9 (1973/74); Delaume, G. R., The Proper Law of State Contracts Revisited, 12 ICSID Review – FILJ 1 (1997); Kreindler, R., The Law Applicable, p. 408.

67 *Autopista v. Venezuela*, Award, 23 September 2003, para. 96.

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their relationship to different systems of law, a process called *dépeçage*.⁶⁸ This is particularly likely to occur where the overall relationship is governed by separate agreements concluded at different times and regulating different issues.⁶⁹

- 41 The parties may also exclude certain parts of a chosen system of law from its application to their relationship. The most common use of this technique is the exclusion of legislation passed by the host State after the conclusion of the investment agreement through a stabilization clause (see paras. 26, 34 *supra*, 117–128 *infra*). The parties may agree to exempt the investor from certain fiscal, foreign exchange or social security legislation.⁷⁰ They may even purport to exclude rules which would limit the capacity of the government to enter into the agreement at issue.⁷¹
- 42 The parties are also free to declare applicable the rules of a treaty that is not in force⁷² or of a non-binding code of conduct such as the World Bank's 1992 Guidelines on the Treatment of Foreign Direct Investment.⁷³ Although the term "rules of law" might indicate that only existing legal rules can be chosen,⁷⁴ there is nothing to stop the parties from adopting their own rules by reference to a document which by itself is not binding. The 1992 Guidelines may be seen as a suitable blueprint for a set of "rules of law" to be agreed by the parties under Art. 42(1).

5. Limits on Choice of Law

a) Reasonable Connection

- 43 Despite the parties' basic freedom to choose the system or rules of law they consider best suited for their relationship, certain limitations to this freedom have been suggested. It is generally accepted that there is no requirement of a reasonable connection of the transaction to the law chosen by the parties in ICSID arbitration. Such a requirement of reasonable connection is mandated in some domestic legal systems to prevent irrational choices of law but is less appropriate in international arbitration where the choice of an unrelated "neutral" legal system may be desirable and rational.⁷⁵

68 See esp. Institute of International Law, Articles on Arbitration between States, State Enterprises or State Entities and Foreign Enterprises, 1989, Art. 6, 63 *Annuaire IDI* II 330 (1990); *Di Pietro, D.*, Applicable Law, p. 238.

69 In *SPP v. Egypt*, a supplementary loan agreement contained a choice of law clause not applicable to the rest of the parties' relationship. See para. 28 *supra*.

70 See e.g., *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, paras. 4.24 *et seq.*

71 See the choice of law rule in *Kaiser Bauxite v. Jamaica*, cited in para. 34 *supra*. But see also paras. 46, 47, 154–156 *infra*.

72 *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, paras. 36–55.

73 Cf. also *Broches*, Convention, Explanatory Notes and Survey, p. 667; *Hirsch*, The Arbitration Mechanism, p. 119.

74 *Masood*, Law Applicable, p. 317.

75 *Branson, D. J./Wallace, R. E.*, Choosing the Substantive Law to Apply in International Commercial Arbitration, 27 *Virginia Journal of International Law* 39 at 53 *et seq.* (1986); *Hirsch*, The Arbitration Mechanism, pp. 125/6.

b) *Mandatory Provisions of the Host State's Law*

A variant of the above theory is the suggestion that certain mandatory or core provisions of the most closely connected system of law, usually the host State's, cannot be dispensed with. Such rules would include the host State's administrative, labour, monetary, regulatory and penal law. These areas of legal regulation would be inherently reserved to the host State and would not be subject to contractual waiver.⁷⁶ 44

While it would probably cause inconvenience to choose a law other than the host State's in these matters (see also para. 27 *supra*), there is no reason why the host State should not have the power to do so.⁷⁷ An investor may be required to apply higher standards of labour law than are otherwise required in the host State. The contract may contain special tax and customs arrangements. The investor may wish to exclude certain aspects of the host State's traditional penal law in relation to his employees. The best that can be said is that the choice of a law other than the host State's in these matters cannot be presumed lightly and that it would require proof of the parties' unequivocal intent. 45

A more difficult question is the exclusion of provisions in the host State's domestic law limiting the authority or capacity of the host State to enter into certain types of arrangements. Thus, some domestic legal systems purport to curtail the capacity of the government to submit to international arbitration or to assent to the application of systems of law other than their own (see Art. 25, para. 625).⁷⁸ In *Kaiser Bauxite v. Jamaica*, the choice of law provision in the 1969 agreement purported to exclude, *inter alia*, any rule of Jamaican law which could throw doubt upon the authority or ability of the Government to enter into agreements between the Parties⁷⁹ (see para. 34 *supra*; *cf.* also paras. 154–156 *infra*). 46

The theoretical question, whether a State can contract out of a rule of its own law limiting its freedom to enter into agreements, is not easy. Much will depend on whether the domestic provision is seen to affect the State's capacity to contract resulting in the agreement's nullity or whether it is seen as a simple prohibition not affecting the agreement's validity. In case of doubt, the latter solution, upholding the validity of the agreement, is to be preferred, especially where the investor has relied in good faith on the host State's capacity to contract.⁸⁰ Nevertheless, provisions of this kind in domestic law should be a cause of concern and should 47

76 *Feuerle*, *International Arbitration and Choice of Law*, p. 108; *Giardina*, *La legge regolatrice*, pp. 683/4.

77 *Goldman*, *Le droit applicable*, pp. 154/5; *Hirsch*, *The Arbitration Mechanism*, p. 126.

78 *Delaume*, *The Proper Law*, pp. 94/5; *Lalive, P.*, *L'Etat en tant que partie à des contrats de concession ou d'investissement conclus avec des sociétés privées étrangères*, in: *1 New Directions in International Trade Law (UNIDROIT)* 317, 326/7 (1977).

79 *Kaiser Bauxite v. Jamaica*, *Decision on Jurisdiction*, 6 July 1975, para. 12.

80 In this sense: *Institute of International Law, Articles on Arbitration between States, State Enterprises, or State Entities and Foreign Enterprises*, 1989, Art. 4, 63 *Annuaire IDI* II 328 (1990).

be investigated thoroughly before relying on a contractual clause purporting to exclude them.⁸¹

c) Public Policy

- 48 Public policy (*ordre public*) is a classic reason for excluding the application of foreign law by domestic courts. It represents the superiority of basic value choices of the local community over the strict application of conflict of laws rules. In the case of ICSID arbitration, there is no domestic legal system which would provide the standards for public policy. A host State's reliance on its own *ordre public* in the face of an agreed choice of law pointing to another system of law is simply a breach of the undertaking to make the chosen law controlling.⁸² For instance, a State, after having consented to the subjection of a loan agreement to French law, could not argue that the obligation to pay interest is contrary to the public policy of its religiously inspired domestic law. Reliance on the *ordre public* of another State in which an ICSID award might have to be enforced⁸³ would be equally unwarranted. Arts. 53 and 54 do not provide for such an exception to the obligation to recognize and enforce awards.⁸⁴
- 49 The matter is different with regard to certain basic international tenets that may be described as international public policy.⁸⁵ These principles would include but not be restricted to peremptory rules of international law. Examples are the prohibition of slavery, piracy, drug trade, terrorism and genocide, the protection of basic principles of human rights, the prohibition to prepare and wage an aggressive war or the use of force contrary to Art. 2(4) of the United Nations Charter. Provisions that would otherwise be applicable, whether contained in an investment agreement or adopted by reference, which violate these basic principles, would have to be disregarded by an ICSID tribunal.⁸⁶ If any theoretical justification is needed for this conclusion, it can be found in the fact that the Convention is rooted in international law which, in a wider sense, is the *lex fori* of ICSID arbitration.
- 50 The application of international public policy to investment contracts is less far-fetched than might appear at first sight. For instance, co-operation in certain forms of weapons production, especially of weapons of mass destruction, could easily be seen to violate one or several of the principles enumerated above. The

81 *Broches, A.*, Choice-of-Law Provisions in Contracts with Governments, 26 *The Record of the Association of the Bar of the City of New York* 42, 54 (1971).

82 See, however, *Grigeria Naón, H. A.*, Choice-of-Law Problems in International Commercial Arbitration 281 (1992).

83 *Feuerle*, International Arbitration and Choice of Law, pp. 108/9.

84 *Hirsch*, The Arbitration Mechanism, p. 127.

85 See *Cremades, B. M./Cairns, D. J. A.*, The Brave New World of Global Arbitration, 3 *The Journal of World Investment and Trade* 173, 205–208 (2002); *Sheppard, A.*, Final Report on Public Policy as a Bar to the Enforcement of Arbitral Awards, ILA Conference London 2000, 340, 345 (2000).

86 *Delaume*, The Proper Law, pp. 90/1; *Feuerle*, International Arbitration and Choice of Law, pp. 107/8; *Hirsch*, The Arbitration Mechanism, pp. 120, 127 *et seq.* See also Institute of International Law, Articles on Arbitration between States, State Enterprises, or State Entities and Foreign Enterprises, 1989, Art. 2, 63 *Annuaire II* 326 (1990).

refusal of an ICSID tribunal to apply and enforce arrangements which serve the violation of one of these principles would be the only appropriate response. The application of international public policy would have to extend to arrangements which violate binding Security Council resolutions under Chapter VII of the UN Charter, even where the resolutions have not been made controlling by a domestic system of law chosen by the parties.

An example for the decisive influence of international public policy is *World Duty Free v. Kenya*.⁵¹ The case arose from a contract for the construction, maintenance and operation of an airport duty free complex which, the Tribunal found, had been procured by corruption. The Tribunal based its decision not only on the express choice of law clauses opting for both English and Kenyan law (see para. 31 *supra*). It also relied on international public policy as evidenced by the widespread condemnation of corrupt business practices in a number of regional and universal instruments outlawing bribery and corruption.⁸⁷ The Tribunal held that the Claimant was not legally entitled to maintain any of its pleaded claims “as a matter of *ordre public international* and public policy under the contract’s applicable laws”.⁸⁸ It reasoned:

157. In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal.⁸⁹

These instances of international public policy should be distinguished from the applicability of international law pure and simple, which will be discussed below in paras. 80–115.⁵²

6. Renvoi

A law determined to be applicable to a transaction may in turn contain rules on the conflict of laws which refer to another legal system. This process is termed *renvoi*.⁵³ The second sentence of Art. 42(1), in referring to the host State’s law, specifically includes its rules on the conflict of laws (see paras. 161–166 *infra*). No such mention is made in the first sentence of Art. 42(1) in connection with the law agreed by the parties. This may be taken as an indication that *renvoi* is not contemplated under the first sentence. Moreover, the first sentence refers to “rules

⁸⁷ E.g., the OAS Inter-American Convention against Corruption, 29 March 1996, 35 ILM 724 (1996); the United Nations Declaration against Corruption and Bribery in International Commercial Transactions, 16 December 1996, 36 ILM 1043 (1997); the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, 21 November 1997, 37 ILM 4 (1998); the Council of Europe Criminal Law Convention on Corruption, 27 January 1999, 38 ILM 505 (1999); the African Union Convention on Preventing and Combating Corruption, 11 July 2003, 43 ILM 5 (2004); and the United Nations Convention against Corruption, 31 October 2003, 43 ILM 37 (2004).

⁸⁸ *World Duty Free v. Kenya*, Award, 4 October 2006, para. 188.

⁸⁹ At para. 157.

of law” rather than to a system of law. Only the latter could be expected to contain conflict of laws rules.

54 A. Broches has explained that this kind of reasoning would not be warranted. Express reference to conflict rules in the first sentence would have been inappropriate precisely because the rules chosen by agreement need not be the rules of a national system. Therefore, it is arguable that the choice of a given national law does not necessarily exclude its conflict provisions.⁹⁰

55 While a purely textual interpretation may leave the question open, an interpretation directed towards the parties’ intention strongly supports the view that an explicit choice of law only refers to the substantive rules of the chosen law but not to the conflict rules contained therein. Unless the parties express a contrary intention, it must be assumed that by their choice of law they did not want to subject their transaction to the uncertainties of *renvoi* to another, as yet undetermined, system of law.⁹¹ In drafting a choice of law clause it may be appropriate to clarify the question through an express reference to the substantive rules of the chosen law or an express exclusion or inclusion of its conflict rules (see para. 81 *infra*).

7. Supervening Choice of Law

56 The normal way to agree on a choice of law is a clause in the initial investment agreement between the host State and the investor (see paras. 22, 24–38 *supra*). If jurisdiction is based on the host State’s legislation or a treaty (see para. 23 *supra*), these may contain a provision on applicable law which is transformed into an agreement on choice of law between the parties upon the acceptance of jurisdiction by the investor (see paras. 63, 80–88 *infra*). If there has been no choice of law by the parties, there is nothing to preclude a later agreement on applicable law.⁹² The institution of arbitration proceedings or the first session of the tribunal may be good opportunities to agree on choice of law.⁹³ The parties may also reach agreement at some later stage during the proceedings.

57 ICSID tribunals have on several occasions addressed the question of whether a choice of law may be made in the course of the proceedings. In *Adriano Gardella v. Côte d’Ivoire*, the Tribunal made a somewhat unclear statement on the Parties’ pleadings which leaves the question open whether the choice of law was made under the first or second sentence of Art. 42(1)⁹⁴ (see para. 207 *infra*).

90 Broches, *The Convention*, pp. 390/1; Broches, *Convention, Explanatory Notes and Survey*, pp. 668/9.

91 Branson, *D. J./Wallace, R. E.*, Choosing the Substantive Law to Apply in International Commercial Arbitration, 27 *Virginia Journal of International Law* 39 at 44/5 (1986); Goldman, *Le droit applicable*, pp. 148/9; Hirsch, *The Arbitration Mechanism*, pp. 130 *et seq.*

92 Delaume, *Le Centre*, pp. 828/9; Delaume, *G. R.*, *Transnational Contracts, Applicable Law and Settlement of Disputes*, Ch. XV, 66/7 (1990); Delaume, *G. R.*, *How to Draft an ICSID Arbitration Clause*, 7 *ICSID Review – FILJ* 168 at 186 (1992); Delaume, *L’affaire*, pp. 44 *et seq.*; Delaume, *The Proper Law*, pp. 19 *et seq.*; Goldman, *Le droit applicable*, p. 192; Hirsch, *The Arbitration Mechanism*, p. 123; Shihata/Parra, *Applicable Substantive Law*, p. 201.

93 Marchais, *B. P.*, *Setting up the Initial Procedural Framework in ICSID Arbitration*, *News from ICSID*, Vol. 5/1, p. 9 (1988).

94 *Adriano Gardella v. Côte d’Ivoire*, Award, 29 August 1977, para. 4.3.

In *SOABI v. Senegal*, the finding on applicable law is equally unclear. After noting the absence of an agreement on applicable law, the Tribunal notes that it appears from the parties' submissions to the Tribunal that they agree that the applicable law is Senegalese law⁹⁵ (see also paras. 145, 146 *infra*). 58

In *Benvenuti & Bonfant v. Congo*, the Parties reached agreement in the course of the arbitration proceedings to authorize the Tribunal to rule *ex aequo et bono*,⁹⁶ a power which was accepted by the Tribunal.⁹⁷ While this agreement did not strictly relate to rules of law in the sense of Art. 42(1), first sentence, it may be inferred that such an agreement reached in the course of the proceedings would be equally acceptable. 59

If jurisdiction is based on national legislation or on a treaty and there is no rule on applicable law in the legislation or treaty, an agreement on applicable law may be reached after the institution of proceedings.⁹⁸ In *AAPL v. Sri Lanka*, the arbitration was initiated under the terms of the Sri Lanka/UK BIT of 1980. The BIT did not contain a provision on applicable law. The Tribunal opened its finding on applicable law with the following observation: 60

19. . . . the Parties in dispute have had no opportunity to exercise their right to choose in advance the applicable law determining the rules governing the various aspects of their eventual disputes.

In more concrete terms, the prior choice-of-law referred to in the first part of Article 42 of the ICSID Convention could hardly be envisaged in the context of an arbitration case directly instituted in implementation of an international obligation undertaken between two States in favour of their respective nationals investing within the territory of the other Contracting State.

20. Under these special circumstances, the choice-of-law process would normally materialize after the emergence of the dispute, by observing and construing the conduct of the Parties throughout the arbitration proceedings.⁹⁹

The Tribunal proceeded to hold that the Parties had by their conduct demonstrated agreement to choose the Sri Lanka/UK BIT as the primary legal source and the relevant rules of international and Sri Lanka domestic law as a supplementary source.¹⁰⁰ The conclusions drawn by the Tribunal from the parties' behaviour may be open to doubt and are discussed below (see paras. 70–79) in the context of implicit choice. But, the basic assumption that the parties may agree on the law applicable to their dispute in the course of the arbitration proceedings appears sound and has not been cast into doubt.¹⁰¹ 61

95 *SOABI v. Senegal*, Award, 25 February 1988, para. 5.02.

96 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 1.22. The suggestion was originally put forward by the Claimants at the Tribunal's first session on 14/15 June 1978 but rejected by the Respondent (para. 1.6). An agreement to this effect was formally reached by the Parties on 5 June 1979 and communicated to the Tribunal (para. 1.22).

97 At paras. 4.4, 4.65. See also para. 259 *infra*. 98 *Kahn*, *The Law Applicable*, pp. 7/8.

99 *AAPL v. Sri Lanka*, Award, 27 June 1990, paras. 19, 20.

100 *Ibid.*, para. 22.

101 *Delaume, G. R.*, ICSID Tribunal Determines That Parties Could and Did Make a Valid Belated Choice of Law, 6 News and Notes from the Institute for Transnational Arbitration 1 at 2 (1991); *Ziadé, N. G.*, Some Recent Decisions in ICSID Cases, 6 ICSID Review – FILJ 514, 517 (1991).

8. *Indirect and Implicit Choice of Law*

62 It is an open question whether a choice of law by the parties must be direct and explicit or can be indirect and implicit and may be inferred from the facts and circumstances of the relationship between the parties. This point was discussed in the course of the Convention's drafting and appears to have been answered in the latter sense (History, Vol. II, pp. 418, 570).¹⁰² On the other hand, assumption of a hypothetical agreement derived from the objective circumstances of a case, a method that is sometimes utilized in private international law, would not be in line with the meaning of Art. 42(1) and is likely to undermine the residual rule of its second sentence. The French version of the Convention, which uses the word "*adoptées*" for "agreed" in the English text, would suggest that the parties must have taken some positive action to justify an assumption of choice of law.¹⁰³ Therefore, no conclusions as to applicable law may be drawn from the fact that the dispute has been submitted to international arbitration¹⁰⁴ and certainly not from the place of proceedings determined under Arts. 62 and 63.¹⁰⁵

a) Choice of Law by Reference to Domestic Legislation

63 National investment laws providing for ICSID's jurisdiction (see para. 23 *supra*) may contain a clause on applicable law.¹⁰⁶ Acceptance by the investor of the offer to consent to jurisdiction would include the acceptance of the clause on applicable law leading to an agreed choice of law. But explicit choice of law clauses of this kind are rare. The mere fact that jurisdiction is based on a provision of the host State's law cannot be taken as a choice of the host State's law. Nor can a jurisdictional provision relating to ICSID for disputes arising out of the interpretation and application of a national investment law necessarily be taken as a general choice of the host State's legal system (see Art. 25, paras. 394, 518–525).

64 Reference in a direct agreement between the parties to an item in the host State's legislation is also not a reliable indication of an intention to choose the host State's

102 See, however, the contrary inferences by *Shihata/Parra*, *Applicable Substantive Law*, p. 190, note 28.

103 *Giardina*, A., *The International Centre for Settlement of Investment Disputes between States and Nationals of Other States (ICSID)*, in: *Essays on International Commercial Arbitration (Sarcevic, P. ed.)* 214 at 217 (1989); *Goldman*, *Le droit applicable*, pp. 142/3; *Shihata/Parra*, *Applicable Substantive Law*, p. 190.

104 *Bowett*, D., *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 59 *BYIL* 49 at 52 (1988); *Delaume*, G. R., *State Contracts and Transnational Arbitration*, 75 *AJIL* 784 at 798/9 (1981); *Delaume*, *The Proper Law*, p. 88; *Lalive*, P., *L'Etat en tant que partie à des contrats de concession ou d'investissement conclus avec des sociétés privées étrangères*, in: *1 New Directions in International Trade Law (UNIDROIT)* 317 at 339/40 (1977).

105 See the clearly erroneous decision of the District Court for the District of Columbia in *MINE v. Guinea*, 505 F. Supp. 141 (1981), 4 *ICSID Reports* 3, in which the Court sought to base the applicability of US legislation on the alleged fact that ICSID arbitration could be expected to take place in the United States. See also Art. 26, para. 9.

106 The Madagascar Investment Code, 1989, Art. 42, provides that, in the case of ICSID arbitration, only the law of Madagascar shall be applicable to the substance of the dispute.

entire legal system. In *LETCO v. Liberia*, the Concession Agreement between the Parties stated in its opening paragraph that it was made under the General Business Law, Title 15 of the Liberian Code of Laws of 1956. The Tribunal concluded that

[t]his appears to indicate an express choice by the parties of the Law of Liberia as the law governing the Concession Agreement.¹⁰⁷

A similar argument was put forward in *SPP v. Egypt*.¹⁰⁸ This case concerned a tourism development project which had been terminated by Egypt, ostensibly to protect undiscovered antiquities in the area. The preamble of the underlying contract, the “Heads of Agreement” of 1974, referred to three items of Egyptian legislation stemming from 1973 and 1974.¹⁰⁹ Paradoxically, both parties were interested in the application of international law in addition to Egyptian law. Egypt relied on the 1972 UNESCO Convention for the Protection of the World Cultural and Natural Heritage. SPP relied on general international law relating to nationalization, expropriation and the termination of foreign investment projects.¹¹⁰ Egypt argued that the reference to Egyptian legislation in the preamble of the 1974 agreement amounted to a choice of Egyptian law. This was corroborated by the fact that one of the items of legislation referred to, Law No. 43 of 1974, provided that “[m]atters not covered by this Law are subject to the applicable laws and regulations”.¹¹¹ Therefore, the role of international law would be limited to those rules and principles incorporated in Egyptian law. This was the case for the 1972 UNESCO Convention.¹¹² SPP denied that an agreement on choice of law in favour of Egyptian law existed and argued that the second sentence of Art. 42(1) would have to be applied leading to the application of Egyptian law and of applicable rules of international law.¹¹³ The Tribunal refused to take a position on this question, holding that:

The Parties’ disagreement as to the manner in which Article 42 is to be applied has very little, if any, practical significance.¹¹⁴

It proceeded to hold that under either solution Egyptian and international law would have to be applied and that the same sources of law would apply under the first and second sentences of Art. 42(1).¹¹⁵ (See also paras. 107–109 *infra*.)

Situations under which a particular agreement on choice of law would lead to the same result as the residual rule in the second sentence of Art. 42(1) are feasible and the situation in *SPP v. Egypt* may have been just such a case. However, this should

107 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 358. See also para. 215 *infra*.

108 *SPP v. Egypt*, Award, 20 May 1992. On this point see esp. *Craig, W. L.*, The Final Chapter in the Pyramids Case: Discounting an ICSID Award for Annulment Risk, 8 ICSID Review – FILJ 264 (1993); *Delaume, G. R.*, The Pyramids Stand – The Pharaohs Can Rest in Peace, 8 ICSID Review – FILJ 231 (1993); *Shihata/Parra*, Applicable Substantive Law, pp. 201/2.

109 *SPP v. Egypt*, Award, 20 May 1992, para. 44.

110 *Craig, op. cit.*, p. 273.

111 See also the Dissenting Opinion to the Award which rests its choice of law arguments primarily on this aspect: *SPP v. Egypt*, Dissenting Opinion, 20 May 1992, 3 ICSID Reports 321 *et seq.*

112 *SPP v. Egypt*, Award, 20 May 1992, paras. 76 *et seq.*

113 At para. 80.

114 At para. 78.

115 At paras. 80 *et seq.*

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not lead to a dismissal of the distinction between the two situations envisaged in Art. 42(1). Despite the relevance of international law even where it is not part of the law chosen by the parties (see paras. 104–115 *infra*), its position is somewhat different and clearly stronger under the residual rule where there is no agreed choice of law (see paras. 204–244 *infra*). Moreover, whether or not the parties have, in fact, agreed on a choice of law also affects the applicability of the conflict of laws rules of the host State’s law (see paras. 53–55 *supra*, 161–166 *infra*). Therefore, the preferable method is the one advocated by *Delaume* under which a tribunal first has to determine whether an agreed choice of law does, in fact, exist before proceeding either under the first or second sentence of Art. 42(1)¹¹⁶ (see para. 13 *supra*).

68 In *Autopista v. Venezuela*, a reference to specific parts of the host State’s legislation in a concession agreement between the investor and the host State was in issue. According to its preamble, the concession agreement was to “be governed by [. . .] [Decree] Law Nr. 138 [. . .] Executive Decree Nr. 502 [. . .] and the provisions of any other laws, regulations, or other documents as may be applicable”.¹¹⁷ In addition, clause 5 of the concession agreement provided that it “shall be governed by [Decree Law 138]; [Executive Decree Nr. 502]; by the Clauses and Annexes [of the Concession Agreement]; by the terms set forth in the Bid submitted by [the investor]; and by the conditions set forth in the Bid Documents”.¹¹⁸ The parties disagreed whether these provisions led to the exclusive application of Venezuelan law. The Tribunal found that clause 5 of the concession agreement led to a valid “partial choice of law” in favour of the two mentioned Venezuelan decrees.¹¹⁹ (See para. 39 *supra*.) However, it found that the reference to specific texts of Venezuelan law did not necessarily amount to a general choice of Venezuelan law.¹²⁰ The Tribunal recognized that such an “extension” of the choice of law was accepted in *LETCO v. Liberia* (see para. 64 *supra*), but it found that the question whether this language constituted an implied choice of any other Venezuelan laws or regulations depended upon the interpretation of the terms “[. . .] and the provisions of any other laws, regulations, or other documents as may be applicable”.¹²¹ According to the Tribunal, “the parties’ mutual intent to submit their contract to Venezuelan law exclusively” could not be sufficiently established. The Tribunal stated:

100. The parties could easily have adopted language showing their common intent to apply exclusively Venezuelan law, i.e., they could easily have expressed their agreement on a general choice of Venezuelan law in the Concession Agreement. Had they meant to provide for international law, they could also have expressed it. But they did not. Failing any indication on record demonstrating that, when agreeing on the Preamble’s wording the parties impliedly meant to

116 *Delaume, G. R., The Pyramids Stand – The Pharaohs Can Rest in Peace*, 8 ICSID Review – FILJ 231 at 241/2 (1993).

117 *Autopista v. Venezuela*, Award, 23 September 2003, para. 94.

118 *Loc. cit.*

119 At para. 96.

120 At para. 97.

121 At para. 98.

provide for a general choice of Venezuelan law or for international law, the Tribunal comes to the conclusion that, except for the matters covered by Venezuelan Decree Law Nr. 138 and Executive Decree Nr. 502, it must look to the second sentence of Article 42(1).¹²²

As a general proposition, it is not convincing to accept the recital of a provision of domestic law or even of an entire piece of legislation in an agreement as a general choice of the domestic law concerned. This *pars pro toto* argument is neither logical nor likely to be indicative of the intention of the parties. Such an argument is particularly unconvincing in the context of an arrangement which allows the parties great latitude in combining, selecting and excluding parts of different legal systems (see paras. 39–42 *supra*). Moreover, it is beyond doubt that certain aspects of the host State’s domestic law will almost inevitably be applicable to the parties’ relationship unless specifically excluded. Therefore, reference to specific aspects of the host State’s law may be seen as clarifying certain details concerning the application of that law but cannot be taken as an implicit general choice of that law. This is not to say that genuine choice of law clauses may not contain reference to specific domestic legislation. Thus, the parties may agree that their contract should be governed by the investment code and other pertinent rules of law of the host State. But in the absence of such a general reference, the choice of a system of law in its entirety cannot be imputed to the parties. **69**

b) Choice of Law through the Parties’ Submissions

Another example of an implicit choice of law rests on the argument that by relying on certain sources of law in their submissions before the tribunal, the parties have demonstrated agreement on the choice of these sources. In *AAPL v. Sri Lanka*, the case was brought to ICSID arbitration under the terms of the Sri Lanka/UK BIT. The conduct of the Parties in the arbitration proceedings led the Tribunal to conclude that: **70**

... both Parties acted in a manner that demonstrates their mutual agreement to consider the provisions of the Sri Lanka/UK Bilateral Investment Treaty as being the primary source of the applicable legal rules.¹²³

After establishing the BIT as the primary source of the applicable legal rules, the Tribunal proceeded to draw conclusions on a general choice of law: **71**

21. . . . the Bilateral Investment Treaty is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by direct reference to certain supplementary rules, whether of international law character or of domestic law nature . . .

22. In fact, the submissions of both Parties . . . clearly demonstrate that they are in agreement about admitting the supplementary role of the recourse – regarding

¹²² At para. 100.

¹²³ *AAPL v. Sri Lanka*, Award, 27 June 1990, at para. 20.

certain issues – to general customary international law, other specific international rules rendered applicable in implementation of the most-favoured-nation clause, as well as to Sri Lankan domestic legal rules.¹²⁴

- 72 Having determined that the BIT had to be applied in the context of international law in general,¹²⁵ the Tribunal used a most-favoured-nation (MFN) clause in the BIT¹²⁶ to apply principles of State responsibility under general international law.¹²⁷ The Tribunal's conclusion is that the respondent Government's responsibility was established under international law.¹²⁸
- 73 The Tribunal's method of establishing the applicable law has been criticized severely,¹²⁹ not least in the Dissenting Opinion attached to the Award,¹³⁰ which points out that the Respondent had no choice but to respond to the Claimant's arguments based on the BIT. This did not necessarily imply a choice of law.¹³¹
- 74 In the absence of a published detailed record of the proceedings, it is impossible to form a definitive opinion as to whether the parties' behaviour did, in fact, demonstrate an agreement on international law as the applicable law. It appears that Sri Lankan law was not fully pleaded during the arbitration proceedings,¹³² which would indicate a failure of the Respondent to insist on the applicability of its own law in accordance with the second sentence of Art. 42(1). Reliance on the BIT could hardly have justified the assumption of an agreement to adopt international law in general as the chosen law. Legal provisions invariably have to be interpreted in the broader context of the legal system to which they belong. This process is quite different from choice of law.
- 75 Unlike in *LETCO* and *SPP* (see paras. 64–66 *supra*), in *AAPL* the acceptance by the Tribunal of an implicit agreement on choice of law was not immaterial. In *AAPL v. Sri Lanka*, a different result concerning the applicable law would have been reached under the residual rule of Art. 42(1), second sentence. The assumption of an agreement in favour of the BIT and of international law in general effectively blocked the application of Sri Lankan law.
- 76 An analysis of *LETCO*, *SPP* and *AAPL*, in which the tribunals accepted an agreement on choice of law by implication, suggests that a stricter standard of

124 At paras. 21, 22.

126 At para. 66.

128 At para. 86.

129 *Asiedu-Akrofi, D.*, Asian Agricultural Products Limited (AAPL) v. Republic of Sri Lanka, 86 AJIL 371 (1992); *Perera, A. R./Dias, N.*, Asian Agricultural Products Ltd. v. The Republic of Sri Lanka, 2 The American Review of International Arbitration 216 (1991); *Vasciannie, S. C.*, Bilateral Investment Treaties and Civil Strife: The AAPL/Sri Lanka Arbitration, 39 Netherlands International Law Review 332 (1992); *Sornarajah, M.*, ICSID Involvement in Asian Foreign Investment Disputes: The Amco and AAPL Cases, 4 Asian Yearbook of International Law 69, 95 *et seq.* (1994); *Chukwumerije, O.*, International Law and Municipal Law in ICSID Arbitration, 1 Canadian Journal of International Business Law and Policy 61, 78 *et seq.* (1996); *Elombi, G.*, ICSID Awards and the Denial of Host State Law, 11 Journal of International Arbitration 61, 65/6 (1994). But see *Amerasinghe, C. F.*, The Prawn Farm (AAPL) Arbitration, 4 Sri Lanka Journal of International Law 155 (1992), who supports the Tribunal's conclusions on choice of law.

130 *AAPL v. Sri Lanka*, Dissenting Opinion, 4 ICSID Reports 296.

131 At p. 310.

132 *AAPL v. Sri Lanka*, Award, 27 June 1990, para. 71; *AAPL v. Sri Lanka*, Dissenting Opinion, 4 ICSID Reports 296, at p. 299. See, however, Award, paras. 36 *et seq.*

125 See also at para. 42.

127 At para. 78.

proof for the existence of such an agreement should be adopted. In these cases there was no unequivocal expression of an agreement. *A. Broches* has expressed the opinion that an agreement under Art. 42(1) requires an affirmative choice and should be express.¹³³ Ironically, in an article published in 1969, *B. Goldman*, one of the arbitrators in the majority in *AAPL v. Sri Lanka*, concluded after a careful analysis of the modes of designation of the applicable law under the Convention that while there was no “*règle impérative de forme*”, the designation of an applicable law had to be perfectly clear.¹³⁴

In other cases, tribunals relied on the submissions of parties merely as corroboration of their findings on applicable law. This was the case in the first Award in *Amco v. Indonesia*. The Tribunal determined that, since the Parties had not expressed agreement as to rules of applicable law, Indonesian law and such rules of international law as it deemed applicable were to be applied (see para. 144 *infra*). The Tribunal found support for this finding in the fact that both parties had not only failed to deny the applicability of these two systems of law but had, in fact, constantly referred to both of them.¹³⁵

In *Wena Hotels v. Egypt*, the Tribunal found that, except for the BIT, there was no special agreement between the parties on the rules of law applicable to the dispute. But the “pleadings of both parties indicate[d] that, aside from the provisions of the [BIT], the Tribunal should apply both Egyptian law (*i.e.* ‘the law of the Contracting State party to the dispute’) and ‘such rules of international law as may be applicable’”.¹³⁶

In *Enron v. Argentina* the Tribunal also relied on the parties’ submissions in order to corroborate its finding that it should apply both host State law and international law.¹³⁷ The Tribunal noted that the parties had “relied on many [...] rules of the Argentine legal system, including the Constitution, the Civil Code, specialized legislation and the decisions of courts”¹³⁸ and that “international conventions [had] been invoked by the parties, as they [had] also discussed the meaning of customary international law”.¹³⁹

c) Reliance on a Clause on Applicable Law in a Treaty

Some treaties providing for ICSID arbitration (Art. 25, paras. 427–463) offer their own rules on applicable law. Acceptance by the investor of an offer to consent

133 *Broches*, The Convention, p. 389; *Broches*, Convention, Explanatory Notes and Survey, p. 667. See also *Kahn*, The Law Applicable, pp. 8/9; *Shihata/Parra*, Applicable Substantive Law, p. 190.

134 *Goldman*, Le droit applicable, p. 144.

135 *Amco v. Indonesia*, Award, 20 November 1984, para. 148. It is possible that the somewhat contradictory finding of the Tribunal in *SOABI v. Senegal*, Award, 25 February 1988 (see paras. 58 *supra* and 145, 146 *infra*), has to be interpreted in this sense. For a more detailed analysis see *Ziadé, N. G.*, Some Recent Decisions in ICSID Cases, 6 ICSID Review – FILJ 514 (1991).

136 *Wena Hotels v. Egypt*, Award, 8 December 2000, para. 79.

137 *Enron v. Argentina*, Award, 22 May 2007, para. 209.

138 At para. 206.

139 At para. 207.

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to jurisdiction includes the acceptance of the clause on applicable law in the treaty leading to an agreed choice of law. Such an acceptance may be expressed simply by instituting proceedings.¹⁴⁰

81 A number of bilateral investment treaties (BITs) contain choice of law clauses.¹⁴¹ Most of these clauses incorporate references to the BIT itself, the law of the State party to the dispute, including its rules on the conflict of laws, and the rules and principles of international law.¹⁴² Some BITs add a reference to agreements relating to the particular investment. For instance, Art. 10 of the Argentina/Netherlands BIT of 1992, after providing for ICSID arbitration, adds:

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 law), 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.¹⁴³

82 Tribunals have held that treaty clauses of this type were the basis for an agreement on choice of law between the host State and the investor. The Tribunal in *Goetz v. Burundi*, applying the BIT between Belgium and Burundi, held:

Without doubt the determination of the applicable law is not, in its true sense, made by the parties to the present dispute (Burundi and the claimant investors) but by the parties to the investment treaty (Burundi and Belgium). As that was a case for the parties' consent, the Tribunal considers however that the Republic of Burundi decided in favour of the applicable law as it is determined in the already cited provision of the Belgium-Burundi investment treaty in becoming a party to this treaty and that the claimant investors have effected a similar choice in lodging their claim for arbitration based on the said treaty. If this is not the first time, as we have noted, that the jurisdiction of the centre results directly from a bilateral treaty for the protection of investments, and not from a distinct agreement between the host State and the investor, it is one of the first times, it seems, that an ICSID Tribunal is called to apply the law as directly determined by such a treaty.¹⁴⁴

83 In *Middle East Cement v. Egypt*, the Tribunal also found that the applicable law was determined by a choice of law provision contained in a BIT. Art. 11 of the

140 *Gaillard, E.*, The Extent of Review of the Applicable Law in Investment Treaty Arbitration, in: *Annulment of ICSID Awards (Gaillard, E./Banifatemi, Y. eds.)* 190, 193/4 (2004); *Kühn, W./Wiegel, U.*, The Application of International Law and Treaty Provisions by Arbitrators, 4(3) *Journal of World Investment and Trade* 451, 471 (2003); *Begic*, *Applicable Law*, p. 25.

141 *Parra, A. R.*, 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); *Peters, P.*, Dispute Settlement Arrangements in Investment Treaties, 22 *Netherlands Yearbook of International Law* 91, 147/8 (1991); *Shihata, I. F. I./Parra, A. R.*, The Experience of the International Centre for Settlement of Investment Disputes, 14 *ICSID Review – FILJ* 299, 336 (1999).

142 See e.g., the US Model BIT of 2004, Art. 30.

143 Many BITs, especially of Latin American countries, contain similar clauses. See *Fedax v. Venezuela*, Award, 9 March 1998, para. 30.

144 *Goetz v. Burundi*, Award, 10 February 1999, para. 94. Footnote omitted.

Bilateral Investment Treaty between Egypt and Greece provided that, “in addition to the rules of the BIT, obligations for a more favourable treatment stemming from the national law of the Contracting Parties or existing under international law between the Contracting Parties [should] prevail”. The Tribunal held that Art. 11 of the BIT was the basis for an agreement on applicable law in the sense of the first sentence of Art. 42. Since the Tribunal found that there were no additional obligations for more favourable treatment, it concluded that it could only consider and accept claims under the Egypt/Greece BIT.¹⁴⁵

In *Siemens v. Argentina*, the applicable BIT provided that a tribunal established under the Treaty should decide on “the basis of this Treaty, and, as the case may be, on the basis of other treaties in force between the Contracting Parties, the internal law of the Contracting Party in whose territory the investment was made, including its rules of private international law, and on the general principles of international law”.¹⁴⁶ In the Tribunal’s view this choice of law provision in the BIT led to an agreement by the parties pursuant to Art. 42(1), first sentence, of the ICSID Convention. The Tribunal held:

[. . .] By accepting the offer of Argentina to arbitrate disputes related to investments, Siemens agreed that this should be the law to be applied by the Tribunal. This constitutes an agreement for purposes of the law to be applied under Article 42(1) of the Convention.¹⁴⁷

Multilateral treaties by which the Contracting States offer consent to ICSID arbitration to investors from other Contracting States (see Art. 25, paras. 456–463) invariably contain clauses on applicable law.¹⁴⁸ These clauses are similarly transformed into agreements on choice of law between the host State and the investor upon the acceptance by the investor of the offer of consent to jurisdiction. The North American Free Trade Agreement (NAFTA) in its Chapter Eleven, Section B, dealing with the settlement of investment disputes, contains the following provision:

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.¹⁴⁹

The Energy Charter Treaty provides similarly in its Art. 26:

145 *Middle East Cement v. Egypt*, Award, 12 April 2002, paras. 86, 87.

146 *Argentina-Germany BIT*, Art. 10(5).

147 *Siemens v. Argentina*, Award, 6 February 2007, para. 76.

148 *Parra, A. R.*, Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 ICSID Review – FILJ 287, 347 (1997).

149 32 ILM 605, 645 (1993). See also *Eklund, C. D.*, A Primer on the Arbitration of NAFTA Chapter Eleven Investor-State Disputes, 11 Journal of International Arbitration 135, 146 (1994); *Burdeau, G.*, Nouvelles perspectives pour l’arbitrage dans le contentieux économique intéressant les états, *Revue de l’arbitrage* 1, 25/6 (1995).

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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.¹⁵⁰

87 In *Kardassopoulos v. Georgia*, the Claimant relied on the Energy Charter Treaty (ECT) as well as on the BIT between Greece and Georgia. The latter contained a clause on applicable law very similar to Art. 26(6) of the ECT. The Tribunal after quoting these provisions said:

... whatever may be the determination of a municipal court applying Georgian law to the dispute, this Tribunal can only decide the issues in dispute in accordance with the applicable rules and principles of international law.¹⁵¹

88 The Colonia Investment Protocol of MERCOSUR (Mercado Común del Sur) in its Art. 9(5) provides that the tribunal shall apply the Protocol itself, the law of the State party to the dispute, including its rules on the conflict of laws, any contracts relating specifically to the investment and the applicable principles of international law. The Cartagena Free Trade Agreement between Mexico, Colombia and Venezuela replicates Art. 1131 of the NAFTA in its Art. 17–20.

d) Reliance on a Treaty as an Implicit Choice of International Law

89 Although many bilateral investment treaties (BITs) contain choice of law clauses,¹⁵² a large number of them do not provide for any express choice of law.¹⁵³ Strictly speaking, this should lead to the application of the default rule of Art. 42(1), second sentence (“In the absence of such agreement, [. . .]”). Nevertheless, ICSID tribunals have treated cases of treaty claims brought on the basis of BITs as involving an implicit choice of international law. In investment treaty arbitration, claimants regularly assert violations of the substantive treatment standards contained in the applicable investment instrument. Even in the absence of any express choice of law provisions, it is generally accepted that the substantive provisions of these treaties constitute the rules of law applicable to the dispute. Whether such an implicit choice of law also encompasses other rules of international law is less clear. It has been suggested that “[t]he treaty being an instrument of international law, it is [. . .] also implicit in such cases that the arbitrators should have recourse to the rules of general international law to supplement those of the treaty”.¹⁵⁴

150 34 ILM 400 (1995). See also *Wälde, T. W.*, International Investment under the 1994 Energy Charter Treaty – Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, 29 *Journal of World Trade* 5, 60 *et seq.* (1995).

151 *Kardassopoulos v. Georgia*, Decision on Jurisdiction, 6 July 2007, para. 146.

152 See previous section.

153 *Gaillard, E.*, The Extent of Review of the Applicable Law in Investment Treaty Arbitration, in: *Annulment of ICSID Awards (Gaillard, E./Banifatemi, Y. eds.)* 190, 194 (2004).

154 *Parra*, Applicable Substantive Law in ICSID Arbitrations Initiated under Investment Treaties, p. 21. See also *Sacerdoti*, Investment Arbitration, p. 24, who reasons that “in case of arbitration on the basis of a BIT, international law, *in primis* the very BIT provisions and the standards

This view was endorsed in *Middle East Cement v. Egypt*, where the Tribunal assessed an applicable law provision in a BIT which provided that, “in addition to the rules of the BIT, obligations for a more favourable treatment stemming from the national law of the Contracting Parties or existing under international law between the Contracting Parties [should] prevail”.¹⁵⁵ The Tribunal stated:

87. [. . .] both according to the 1st sentence of Art. 42 (1) as the rules of law chosen by the Parties in Art. 11 of the BIT and according to the 2nd sentence of Art. 42 (1) of the ICSID Convention as “rules of international law as may be applicable”, the reference to and application of the BIT implies that the Tribunal may have recourse to the rules of general international law to supplement those of the BIT.¹⁵⁶

In *MTD v. Chile*¹⁵⁷ the Tribunal had to determine the applicable law in a dispute brought under the Chile-Malaysia BIT which did not contain a choice of law. The Tribunal rejected the Respondent’s argument that the ICSID Convention required – in the absence of agreement between the parties – the application of Chilean legislation. The Tribunal “limit[ed] itself to note that, for purposes of Article 42(1) of the Convention, the parties [had] agreed to this arbitration under the BIT. This instrument being a treaty, the agreement to arbitrate under the BIT require[d] the Tribunal to apply international law.”¹⁵⁸ This reasoning was subsequently reaffirmed when the Tribunal asserted that “[t]his being a Tribunal established under the BIT, it [was] obliged to apply the provisions of the BIT [. . .]”.¹⁵⁹ For the Tribunal it followed that domestic law was secondary:

The breach of an international obligation will need, by definition, to be judged in terms of international law. To establish the facts of the breach, it may be necessary to take into account municipal law.¹⁶⁰

The Tribunal in *CSOB v. Slovakia* endorsed the implicit choice of international law by way of a BIT in more cautious terms. In that case the claim was based on a “Consolidation Agreement” (CA) which provided:

This agreement shall be governed by the laws of the Czech Republic and the [BIT].¹⁶¹

The Tribunal found that this meant that international law had to be applied to the extent necessary for the BIT’s interpretation:

Even to the extent the CA is not governed by international law as such, the BIT, as it is incorporated into the CA, has to be interpreted in the context of the legal system under which it has been drafted. Consequently, the incorporation of the BIT includes the rules of international law that are relevant for its interpretation.¹⁶²

of treatment and protection they refer to, have to be applied, including when the BIT does not contain any indication as to the applicable law”.

155 *Middle East Cement v. Egypt*, Award, 12 April 2002, para. 86.

156 At para. 87.

157 *MTD v. Chile*, Award, 25 May 2004.

158 At para. 87.

159 At para. 112.

160 At para. 204.

161 *CSOB v. Slovakia*, Award, 29 December 2004, para. 61.

162 At para. 63.

93 In *ADC v. Hungary*, the BIT did not contain a choice of law clause.¹⁶³ The Tribunal found that consent to arbitration under the BIT implied a choice of the BIT as the applicable law. This, in turn, implied a choice of international law in general. The Tribunal said:

290. In the Tribunal's view, by consenting to arbitration under Article 7 of the BIT [. . .] the Parties also consented to the applicability of the provisions of the Treaty [. . .]. Those provisions are Treaty provisions pertaining to international law. That consent falls under the first sentence of Article 42(1) of the ICSID Convention ("The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties"). The consent must also be deemed to comprise a choice for general international law, including customary international law, if and to the extent that it comes into play for interpreting and applying the provisions of the Treaty.¹⁶⁴

94 The concept of an implicit choice of international law through the invocation of a BIT was discussed but not followed in *LG&E v. Argentina*. The Tribunal reasoned as follows:

85. It is to be noted that the Argentine Republic is a signatory party to the Bilateral Investment Treaty, which may be regarded as a tacit submission to its provisions in the event of a dispute related to foreign investments. In turn, LG&E grounds its claim on the provisions of the Treaty, thus presumably choosing the Treaty and the general international law as the applicable law for this dispute. Nevertheless, these elements do not suffice to say that there is an implicit agreement by the Parties as to the applicable law, a decision requiring more decisive actions. Consequently, the dispute shall be settled in accordance with the second part of Article 42(1).¹⁶⁵

95 Although the Tribunal continued to address the issue of the applicable law under the second sentence of Art. 42(1) (see paras. 203, 226, 238 *infra*), its solution came very close to the concept of an implicit choice of international law. The *LG&E* Tribunal cited the view "[. . .] that when submitting the settlement of a dispute to an Arbitral Tribunal acting within the framework of an international agreement, like ICSID, the dispute falls under public international law; thus its rules are to be applied".¹⁶⁶ Finally, the Tribunal concluded that it would first apply the BIT, second, "in the absence of explicit provisions therein, general international law, and, third, the Argentine domestic law".¹⁶⁷

9. The Applicability of International Law

a) International Law as the Chosen Law

96 There is no doubt that a choice of international law by the parties either in conjunction with a national law or on its own is valid and has to be respected by the tribunal (see paras. 33–36 *supra*). The most common agreement of this kind,

163 Somewhat confusingly, the Tribunal quoted the choice of law clause from the BIT's provision on State-State arbitration: *ADC v. Hungary*, Award, 2 October 2006, para. 290.

164 *ADC v. Hungary*, Award, 2 October 2006, para. 290.

165 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 85. Footnote omitted.

166 At para. 93.

167 At para. 99.

a combined choice of the law of the host State and of international law (see paras. 80–84 *supra*), would produce a result similar to the residual rule of Art. 42(1), second sentence. But an exclusive reference to international law such as in the NAFTA and in the Energy Charter Treaty (see paras. 85–88 *supra*) is also feasible.

In *AGIP v. Congo*, the parties had agreed on the application of Congolese law supplemented by the principles of international law (see para. 33 *supra*). After establishing that the Congolese ordinance, which had nationalized the Claimant’s property, was in breach of Congolese law, the Tribunal turned to international law:

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80. These observations, with respect to Congolese Law, do not, however, exempt the Tribunal from examining the acts of nationalization from the point of view of international law.

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82. In the present case, it must be recalled, that according to Article 15 of the Agreement, Congolese law can be “supplemented” when the occasion arises by principles of international law.

83. It has been maintained by AGIP that the qualification of “supplemented” must be interpreted as implying the subordination of Congolese law to international law. Whatever the merits of this argument it suffices for the Tribunal to note that the use of the word “supplemented” signifies at the very least that recourse to principles of international law can be made either to fill a lacuna in Congolese law, or to make any necessary additions to it.¹⁶⁸

The Tribunal proceeded to look at the compatibility of the nationalization with international law in the light of a stabilization clause. It pointed out that it was using the principles of international law to “complete” Congolese law. On this basis, it reached the result that the nationalization was irregular in nature and led to an obligation to compensate the Claimant¹⁶⁹ (see para. 120 *infra*). The Tribunal’s use of the words “supplement”, “addition” and “complete” in describing the relationship of international law to the host State’s law is not very precise.¹⁷⁰ Nevertheless, the circumstances of the case permit the conclusion that the claim would have been upheld even if the host State’s actions had been found legal under Congolese law (see also para. 220 *infra*).

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In *AAPL v. Sri Lanka*, the Tribunal reached the conclusion that the parties had by their conduct in the arbitration proceedings made an implicit choice of law in favour of the Sri Lanka/UK BIT and hence of international law in general (see paras. 70–72 *supra*). Although reference was made to the admissibility of recourse to Sri Lankan domestic legal rules (para. 22 of the Award; see para. 71 *supra*), the decision is, in fact, completely dominated by considerations of international law. Similarly, Tribunals that found that reliance on a BIT implied a general choice of international law (see paras. 90, 91 *supra*) concentrated on the application of the BIT as interpreted in the light of international law.

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168 *AGIP v. Congo*, Award, 30 November 1979, paras. 80 *et seq.*

169 At para. 88.

170 *Broches*, Convention, Explanatory Notes and Survey, pp. 671 *et seq.*

b) International Law as Part of Domestic Law

- 100** International law is frequently incorporated into domestic law through a variety of techniques.¹⁷¹ To the extent that it thereby becomes applicable internally, it may be seen as part of a system of domestic law chosen by the parties and may be relied upon before an ICSID tribunal (see para. 200 *infra*).¹⁷² In *Adriano Gardella v. Côte d'Ivoire*¹⁷³ (see paras. 57 *supra*, 207 *infra*) and *LETCO v. Liberia*¹⁷⁴ (see paras. 64 *supra*, 215 *infra*), the respective Tribunals found the law of the host State to be applicable. In response to arguments for the Claimants that international law should be applied as well, the Tribunals pointed out that no divergence existed between the chosen domestic law and international law, since the former was in full accord with the latter (see also para. 106 *infra*).
- 101** The *ad hoc* Committee in the annulment proceedings of *Wena Hotels v. Egypt* noted that, under the Egyptian Constitution, treaties that had been ratified and published had the force of law. It further noted that a number of important domestic laws contained a “without prejudice clause” in favour of the relevant treaty provisions. According to the *ad hoc* Committee, “[t]his amount[ed] to a kind of *renvoi* to international law by the very law of the host State”.¹⁷⁵ It further held “that when a tribunal applies the law embodied in a treaty to which Egypt is a party it is not applying rules alien to the domestic legal system of this country”.¹⁷⁶
- 102** In a series of decisions relating to Argentina, ICSID Tribunals similarly noted that, according to the Argentine Constitution, treaties are the supreme law of the nation, and have primacy over domestic laws.¹⁷⁷
- 103** Still, it would not be wise to rely on the incorporation of international law into domestic law as a general proposition. The status of international law under domestic constitutions varies greatly. Some constitutions do not provide for an automatic application of certain parts of international law but require specific incorporation by legislation. Even where there are constitutional provisions to this effect, their import is often uncertain. Subsequent domestic enactments may take precedence over treaties or customary international law or both. Certain parts of international law may be regarded as non-self-executing or may be defeated by other doctrines such as Act of State or Political Question. Finally, even constitutional provisions

171 Oppenheim's International Law, 9th edition, 54 *et seq.* (1992).

172 *Broches*, The Convention, p. 389; *Delaume*, The Proper Law, p. 89. The States parties in *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 207 (see para. 47 *supra*), and in *AAPL v. Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 257, referred to certain treaties as part of their own domestic law. However, in neither case did the Tribunal accept the host State's law as the law chosen by agreement.

173 *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, para. 4.3.

174 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 343.

175 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, para. 42.

176 At para. 44.

177 *CMS v. Argentina*, Award, 12 May 2005, paras. 119, 120; *Azurix v. Argentina*, Award, 14 July 2006, para. 65; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, paras. 90, 91; *Siemens v. Argentina*, Award, 6 February 2007, para. 79; *Enron v. Argentina*, Award, 22 May 2007, para. 208; *Sempra v. Argentina*, Award, 28 September 2007, paras. 237, 238.

mandating the application of international law may be amended or defeated by other constitutional provisions authorizing or directing action which is contrary to international law. An investor seeking protection in international law must be advised not to put its faith in references to international law in the law of the host State, but to insist either on its explicit inclusion in a choice of law clause or on the application of the second sentence of Art. 42(1).¹⁷⁸

c) International Law in the Absence of its Choice

The question remains whether international law will be taken into account by an ICSID tribunal where it is not included in the formula on choice of law agreed to by the parties. At first sight a negative reply would be indicated by the juxtaposition of the first and second sentences of Art. 42(1). Whereas the second sentence includes a reference to applicable rules of international law, the first sentence does not. A. Broches has explained this omission as a matter of drafting technique. The first sentence speaks of “rules of law” rather than of a system of national law. Since such “rules of law” may be national as well as international, a separate reference to international law would have been out of place.¹⁷⁹

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The principle of freedom of choice of law (see para. 21 *supra*) would also indicate that a failure to mention international law in an agreement actually amounts to a negative choice of law effectively excluding its applicability. Several authors have, in fact, drawn this conclusion arguing that the application of international law in this situation would violate the parties’ declared will.¹⁸⁰ Nevertheless, the practice of ICSID tribunals, the overwhelming weight of writers and important policy considerations all indicate that there is at least some place for international law even in the presence of an agreement on choice of law which does not incorporate it.

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In *LETCO v. Liberia*, the Tribunal determined that a reference to Liberian legislation in the concession agreement “appears to indicate an express choice by the parties of the Law of Liberia”¹⁸¹ (see para. 64 *supra*). The Claimant had argued that no express choice of law had been made and that, in accordance with the second sentence of Art. 42(1), international law should also be applied. The Tribunal pointed out that, though the Contracting State’s law is recognized as paramount within its own territory, it is nevertheless subjected to the control of international law¹⁸² (see para. 215 *infra*). After confirming the general compliance of Liberian law with the generally accepted principles of public international law,

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178 Kreindler, R., *The Law Applicable*, p. 414.

179 Broches, *Convention, Explanatory Notes and Survey*, p. 668.

180 Bettems, D., *Les contrats entre Etats et entreprises étrangères* 76, 79 (1989); Masood, *Law Applicable*, p. 319; Toope, S. J., *Mixed International Arbitration. Studies in Arbitration Between States and Private Persons* 238/9 (1990); Chukwumerije, *International Law and Municipal Law*, pp. 69 *et seq.*; Nassar, N., *Internationalization of State Contracts: ICSID, The Last Citadel*, 14 *Journal of International Arbitration* 185, 196 *et seq.* (1997).

181 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 358.

182 *Loc. cit.*

the Tribunal proceeded to examine the legality of the revocation of the concession and the question of damages under both Liberian and international law. It came to the conclusion that

... both according to international law and, more importantly, Liberian law, LETCO is entitled to compensation for damages . . .¹⁸³

107 In *SPP v. Egypt*, there was also disagreement as to whether a choice of Egyptian law had been made by the Parties and, consequently, whether international law was applicable in conformity with the residual rule of Art. 42(1), second sentence. The Tribunal declared this disagreement immaterial, holding that the same sources of law would have to be applied either way (see paras. 65, 66 *supra*). It found:

80. Finally, even accepting the Respondent's view that the Parties have implicitly agreed to apply Egyptian law, such an agreement cannot entirely exclude the direct applicability of international law in certain situations. The law of the ARE [Arab Republic of Egypt], like all municipal legal systems, is not complete or exhaustive, and where a lacuna occurs it cannot be said that there is agreement as to the application of a rule of law which, *ex hypothesi*, does not exist. In such case, it must be said that there is "absence of agreement" and, consequently, the second sentence of Article 42(1) would come into play.¹⁸⁴

108 The Tribunal proceeded to apply international law to defeat an Egyptian argument that certain acts of its officials were invalid under Egyptian law. It held that these acts created expectations protected by the application of the principle of international law establishing the international responsibility of States for unauthorized or *ultra vires* acts of officials having an official character:

83. Whether legal under Egyptian law or not, the acts in question were the acts of Egyptian authorities, including the highest executive authority of the Government. These acts, which are now alleged to have been in violation of the Egyptian municipal legal system, created expectations protected by established principles of international law. A determination that these acts are null and void under municipal law would not resolve the ultimate question of liability for damages suffered by the victim who relied on the acts. If the municipal law does not provide a remedy, the denial of any remedy whatsoever cannot be the final answer.

84. When municipal law contains a lacuna, or international law is violated by the exclusive application of municipal law, the Tribunal is bound in accordance with Article 42 of the Washington Convention to apply directly the relevant principles and rules of international law.¹⁸⁵

The Tribunal continued to apply international law in a variety of contexts.¹⁸⁶

109 It is true that the Tribunal never made a determination that Egyptian law was the law chosen by the Parties. However, its insistence that international law was to be applied either way indicates that international law will not be ousted by a simple choice of a national system of law. The Tribunal's reasoning as to lacunae

¹⁸³ At p. 372.

¹⁸⁴ *SPP v. Egypt*, Award, 20 May 1992, para. 80.

¹⁸⁵ At paras. 83 *et seq.*

¹⁸⁶ At paras. 153 *et seq.*, 190, 222 *et seq.*

in the chosen domestic law pointing towards an absence of agreement in the sense of Art. 42(1), first sentence, and hence leading to the application of international law in accordance with Art. 42(1), second sentence, may be open to doubt and has, in fact, been criticized.¹⁸⁷ What the Tribunal did, in fact, was not the closing of lacunae but the subjection of the national law to the scrutiny and control of international law. The example of the *ultra vires* acts of Egyptian officials shows that the answer offered by Egyptian domestic law was simply superseded by the solution mandated by international law.

The Tribunal in *Autopista v. Venezuela* affirmed the view that the corrective function of international law (see paras. 214–235 *infra*) was also relevant in the case of a choice of law in favour of domestic law. In the specific dispute, the Tribunal had to decide the question of the applicable law on the basis of Art. 42(1), second sentence, ICSID Convention (see paras. 224, 225 *infra*). Nevertheless, the Tribunal expressly considered

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[it] a well accepted practice that the national law governing by virtue of a choice of law agreement (pursuant to Article 42(1) first sentence of the ICSID Convention) [was] subject to correction by international law in the same manner as the application of the host state law failing an agreement (under the second sentence of the same treaty provision).¹⁸⁸

The Tribunal in *Duke Energy v. Peru* also stressed the corrective function of international law even in the absence of its choice.¹⁸⁹ The Tribunal found that the agreement between the investor and the host State did not contain a specific choice regarding the applicable substantive law and that thus the default rule of Art. 42(1), second sentence, ICSID Convention had to apply (see paras. 133 *et seq. infra*). It added, however, that

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even if the law of Peru were held to apply to the interpretation of the [agreement between the investor and the host State], this Tribunal has the authority and duty to subject Peruvian law to the supervening control of international law.¹⁹⁰

Despite a lack of methodical rigor in these decisions and the fact that some of them were *obiter dicta*, this practice shows a general reluctance to abandon international law in favour of the host State's domestic law. The complete exclusion of standards of international law as a consequence of an agreed choice of law pointing towards a domestic legal system would indeed lead to some extraordinary consequences. It would mean that an ICSID tribunal would have to uphold discriminatory and arbitrary action by the host State, breaches of its undertakings which are evidently in bad faith or amount to a denial of justice as long as they

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187 See the Dissenting Opinion, 3 ICSID Reports 321 *et seq.*; *Delaume, G. R.*, The Pyramids Stand – The Pharaohs Can Rest in Peace, 8 ICSID Review – FILJ 231 at 248, 261 (1993); *Delaume, L'affaire*, p. 48.

188 *Autopista v. Venezuela*, Award, 23 September 2003, para. 207. The Tribunal's reasoning on this point expressly relied upon the First Edition of this Commentary.

189 *Duke Energy v. Peru*, Decision on Jurisdiction, 1 February 2006, para. 162, footnote 52, also relying on the First Edition of this Commentary.

190 At para. 162.

conform to the applicable domestic law, which is most likely going to be that of the host State. It would mean that a foreign investor, simply by assenting to a choice of law, could sign away the minimum standards for the protection of aliens and their property developed in customary international law. Such a solution would hardly be in accordance with one of the goals of the Convention, namely

... promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those countries which wish to attract it.¹⁹¹

113 The idea that a choice of law clause might be construed as a waiver of the substantive standards of international law is not entirely without parallel in the procedural field. Under so-called Calvo Clauses investors were induced, especially by Latin American host States, to waive any rights to diplomatic protection by their home States. These clauses were less than successful and have been looked upon with some reserve by arbitral tribunals.¹⁹² The limited success of a clause that was specifically designed to exclude remedies under international law must cast grave doubt on the ability of a choice of law clause to exclude international minimum standards by the mere omission of a reference to international law. In addition, it is highly unlikely that parties intend to make a choice to the total exclusion of international law including the international minimum standards.

114 It is for these and similar reasons that a number of authors have advocated the retention of international standards for the protection of foreign investments, even in the face of a choice of law clause pointing towards the host State's domestic law alone.¹⁹³ As early as 1968, *E. Lauterpacht* (as he then was) has pointed out that the competence of an ICSID tribunal to pass upon questions of international law is inherent in its very status as a tribunal to dispose of issues under international investment contracts in substitution for alternative modes of international protection.¹⁹⁴ Other authors have elaborated on this theme pointing out that it would be extraordinary if the traditional procedure of diplomatic protection ousted by Art. 27 of the Convention were to be replaced by a procedure which ignored internationally guaranteed minimum standards.¹⁹⁵ In a similar vein, the prospect of awards which are in disregard of international law would be difficult to reconcile

191 Report of the Executive Directors, para. 9.

192 *García-Amador, F. V.*, Calvo Doctrine, Calvo Clause, in: *Encyclopedia of Public International Law*, Vol. I, 521 (1992); *Shea, R. R.*, *The Calvo Clause* (1955).

193 *Curtis*, *The Legal Security of Economic Development Agreements*, pp. 325 *et seq.*; *Burdeau, G.*, *Nouvelles perspectives pour l'arbitrage dans le contentieux économique intéressant les états*, *Revue de l'arbitrage*, 1 at 5 (1995); *Feuerle*, *International Arbitration and Choice of Law*, pp. 110 *et seq.*; *Firth*, *The Law Governing Contracts*, pp. 262 *et seq.*; *Goldman*, *Le droit applicable*, pp. 151 *et seq.* For a broad investigation see *Lillich, R. B.*, *The Law Governing Disputes*, p. 61.

194 *Lauterpacht, E.*, *The World Bank Convention on the Settlement of International Investment Disputes*, in: *Recueil d'études de droit international en hommage à Paul Guggenheim* 658 (1968).

195 *Muchlinski, P. T.*, *Dispute Settlement under the Washington Convention on the Settlement of Investment Disputes*, in: *Control over Compliance with International Law* (*Butler, W. E.* ed.) 175 at 186 (1991); *Craig, W. L.*, *The Final Chapter in the Pyramids Case: Discounting an*

with the general obligation to recognize and enforce awards under Art. 54(1) of the Convention.¹⁹⁶ Other authors have demanded that any agreed exclusion of international law must be made perfectly clear,¹⁹⁷ thereby indicating that the mere omission of its mention in a choice of law clause would not be sufficient to achieve this result.

The weight of the arguments outlined above strongly militates in favour of the preservation of the international minimum standards, even in the absence of a reference to international law in a choice of law clause. Apart from the highly undesirable results that may arise from a complete disregard for international law and the incompatibility of such a course of action with the purpose and overall system of the Convention, it is doubtful whether this problem can be adequately dealt with in terms of choice of law. The mandatory rules of international law, which provide an international minimum standard of protection for 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. This assertion is quite different from questions of applicable law under the conflict of laws. International law does not thereby become the law applicable to the contract. The transaction remains governed by the domestic legal system chosen by the parties. However, this choice is checked by the application of a number of mandatory international rules such as the prohibition of denial of justice, the discriminatory taking of property or the arbitrary repudiation of contractual undertakings.

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10. Subsequent Changes in the Chosen Law

For the investor, the most dangerous aspect of choosing the host State's domestic legal system is the prospect of subsequent changes in that law which affect the investment. This is particularly so where the host State's law is chosen exclusively. Subsequent changes in the governing law may have an incisive effect on the parties' relationship, going as far as the complete termination of a contract and the expropriation of the investor's property. Such action may be taken in conformity with the host State's constitutional requirements. In fact, measures causing injury to a foreign investor are frequently presented in the form of a change of domestic law. It is evident that exclusive reliance on domestic law and on domestic remedies will be of little or no use in a situation of this kind. Other changes in the host State's law are less dramatic but may still have a profound impact on the investor's activities. They include changes in taxation and labour standards, environmental

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ICSID Award for Annulment Risk, 8 ICSID Review – FILJ 264 at 275 (1993); *Giardina*, La legge regolatrice, pp. 687 *et seq.*

196 The *ad hoc* Committee in *Amco v. Indonesia* has echoed these considerations in the context of an absence of choice of law. *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 21. See para. 194 *infra*. These observations are equally valid where the parties have chosen the host State's law.

197 *Broches*, The Convention, Explanatory Notes and Survey, p. 669.

regulations and zoning laws, the freezing of tariffs for utilities and other aspects of the regulatory framework for the investor's operations.

a) Stabilization Clauses

- 117** One technique to shield a foreign investor from the consequences of a change in the host State's law is the insertion of a stabilization clause into the investment contract. Under such a clause, the host State undertakes to leave the investor unaffected by subsequent changes of the local law. This is not a prohibition to change the law but merely a promise not to apply any changes vis-à-vis the investor or a promise to compensate the investor for any adverse consequences of such a change. From the investor's perspective, the law becomes frozen at the time of the contract. Put differently, the parties' choice of law is specified also in terms of the chosen law's evolution over time. The rules of law agreed to by the parties are only those enacted up to the date of the contract. In order to immunize stabilization clauses against their abrogation by subsequent national law of the host State, it is sometimes said that they are governed by international law even if otherwise the chosen law is domestic law. Despite some debate concerning the precise legal foundations of stabilization clauses and their relationship to the host State's sovereign right to legislate, arbitral practice,¹⁹⁸ as well as scholarly writings,¹⁹⁹ indicate that these clauses are binding and should be respected.
- 118** ICSID Model Clause 10 of 1993²⁰⁰ dealing with applicable law contains a reference to the possibility to stabilize the chosen law. It suggests the insertion of the words "as in force on the date on which this agreement is signed" (see para. 22 *supra*).²⁰¹ Stabilization clauses have, in fact, been used repeatedly in contracts providing for ICSID arbitration (see paras. 26, 34 *supra*, 119–128 *infra*).
- 119** Stabilization clauses need not be comprehensive but may be used selectively. It is possible to apply them only to special areas of concern. Thus, they may be directed to taxation or company law but not to other areas of the host State's law.

198 *TOPCO v. Libya*, Award, 19 January 1977, 17 ILM 1, 24 (1978); *Kuwait v. Aminoil*, Award, 24 March 1982, 66 ILR 519, 586 *et seq.*, 621 *et seq.* (1984).

199 *Begic*, Applicable Law, pp. 84–96; *Curtis*, The Legal Security of Economic Development Agreements, pp. 346 *et seq.*; *Coale, M.*, Stabilisation Clauses in International Petroleum Transactions, 30 *Denver Journal of International Law & Policy* 217 (2003); *Delaume*, The Proper Law, pp. 23 *et seq.*; *Faruque, A.*, Validity and Efficacy of Stabilisation Clauses, 23 *Journal of International Arbitration* 317 (2006); *Hansen, T. B.*, The Legal Effect Given Stabilization Clauses in Economic Development Agreements, 28 *Virginia Journal of International Law* 1015 (1988); *Giardina*, La legge regolatrice, pp. 684 *et seq.*; *Hirsch*, The Arbitration Mechanism, pp. 141 *et seq.*; *Lillich, R. B.*, The Law Governing Disputes, pp. 97 *et seq.*; *Wälde, Th./Ndi, G.*, Stabilizing International Investment Commitments: International Law versus Contract Interpretation, 31 *Texas International Law Journal* 215 (1996); *Weil, P.*, Les clauses de stabilisation ou d'intangibilité insérées dans les accords de développement économique, in: *Mélanges offerts à Charles Rousseau: La communauté internationale* 301 (1974); and the authorities cited by these authors.

200 4 ICSID Reports 364.

201 Earlier versions of the Model Clauses also offered formulas for stabilization. See the 1981 Model Clause XVII, 1 ICSID Reports 206 and the 1968 Model Clauses XIX and XX, 7 ILM 1176 (1968).

Selective stabilization clauses provide additional flexibility and may be easier to obtain than comprehensive clauses.²⁰² An example for such a selective stabilization is offered by the Principal Agreement underlying the *Kaiser Bauxite v. Jamaica* case which contained a “no further tax” clause.²⁰³

ICSID tribunals have adopted a favourable attitude towards stabilization clauses. In *AGIP v. Congo*, the chosen law was Congolese law supplemented by international law (see para. 33 *supra*). The agreement between the parties contained clauses protecting the investor against certain subsequent changes of Congolese law: the Government undertook not to apply ordinances or subsequent decrees the object of which would be to change the private joint-stock character of the Company set up locally and promised in the event of modifications to the company laws to enact appropriate provisions to ensure that these modifications would not affect the structure and composition of the organs of the Company.²⁰⁴ The Tribunal, after examining the legality of the Company’s nationalization under Congolese law, turned to the situation under international law, pointing out that the act of nationalization was, after all, itself a piece of Congolese law which might provide a juridical basis for the measures (see paras. 97, 98 *supra*). After reciting the clauses, the Tribunal said:

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86. These stabilization clauses, which were freely entered into by the Government, do not affect the principle of its legislative and regulatory sovereignty since it retains both with respect to those, whether nationals or foreigners, with whom the Government has not entered into such undertakings, and that, in the present case, they are limited to rendering the modifications to the legislative and regulatory provisions provided for in the Agreement, unopposable to the other contracting party.

87. [. . .] It suffices to concentrate the examination of the compatibility of the nationalization with international law on the stabilization clauses.

88. It is indeed in connection with these clauses that the principles of international law are used to complete the rules of Congolese Law. The reference made to international law suffices to demonstrate the irregular nature, from the point of view of this law, of the acts of nationalization carried out in the present case. It follows that the Government is obliged to compensate AGIP for the damage suffered by it as a result of the nationalization . . .²⁰⁵

This decision shows not only a general deference to the stabilization clauses but also a willingness to regard them as part of international law, thereby shielding them against unilateral abrogation through host State legislation.

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In other cases, stabilization clauses did not play a central role in the tribunals’ reasoning but were referred to as an effective way to safeguard the rights of

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202 *Glossner, O./Bartels, M.*, Internationale Bergbauvorhaben und Vertragspraxis für die Beilegung von Streitigkeiten, 28 *Recht der Internationalen Wirtschaft/Außenwirtschaftsdienst des Betriebs-Beraters* 555, 561 (1982).

203 *Kaiser Bauxite v. Jamaica*, Decision on Jurisdiction, 6 July 1975, para. 12. The Tribunal did not reach the question of the clause’s relevance.

204 *AGIP v. Congo*, Award, 30 November 1979, paras. 68–70.

205 At paras. 86–88.

investors. In *LETCO v. Liberia*, the Tribunal determined that there had been a choice of Liberian law (see para. 64 *supra*). The Concession Agreement contained the following general stabilization clause:

Except as otherwise provided in this Agreement, no amendment or repeal of any law or regulation governing this Agreement or any part thereof shall affect the rights and duties of the CONCESSIONAIRE without its consent.²⁰⁶

123 After pointing out that it had found no indication that the laws of Liberia had been changed so as to affect the Concession Agreement, the Tribunal offered the following observation:

This clause, commonly referred to as a “Stabilization Clause”, is commonly found in long-term development contracts and, as is the case with notification procedures of the Concession Agreement, is meant to avoid the arbitrary actions of the contracting government. This clause must be respected, especially in this type of agreement. Otherwise, the contracting State may easily avoid its contractual obligations by legislation.²⁰⁷

124 In *MINE v. Guinea*, the parties had agreed on Guinean law in force on the date of signature (see para. 26 *supra*) and specified that their agreement would be binding:

nonobstant toutes les dispositions du droit interne public, administratif ou privé, qui pourraient intervenir en Guinée, et ce, sans exception ni réserve.²⁰⁸

125 The *ad hoc* Committee observed that subsequent Guinean legislation could not affect the agreement and that the agreement could be said to have “frozen” the applicable law.²⁰⁹

126 In *SEMOS v. Mali*, stability guarantees were contained in national legislation as well as in agreements (“Conventions”) with the investor. The Tribunal said:

[. . .] the 1999 wording of Article 993 of the General Tax Code of Mali constitutes an innovation in relation to the legal texts in force when the Amended Convention was signed. As such, it is not applicable to Semos, in view of the guarantee of the stability of the fiscal and customs regime the company enjoys under the 1970 and 1991 Mining Codes, as well as under the Original and Amended Conventions which are applicable to it.²¹⁰

127 In *CMS v. Argentina*, the Claimant’s licence contained a specific undertaking that the tariff structure would not be subject to further regulation or price control, as well as a more general undertaking that the basic rules governing the licence would not be amended.²¹¹ The Tribunal said:

The important question, [. . .], is that concerning the right to benefit from stabilization clauses. This discussion is well known in international law and to the

206 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 368.

207 *Loc. cit.*

208 *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 6.33.

209 At para. 6.36.

210 *SEMOS v. Mali*, Award, 25 February 2003, 10 ICSID Reports 116, 126.

211 *CMS v. Argentina*, Award, 12 May 2005, paras. 145–151.

extent this dispute concerns the simultaneous operation of the License and protection under the Treaty, the stabilization ensured a right that the Claimant can properly invoke.²¹²

In *Duke Energy v. Peru*, the Foreign Investment Law was the basis for the conclusion of “legal stability agreements” (LSAs) which provided for the stabilization of legal regimes applicable to various fundamental rights of foreign investors.²¹³ The Tribunal held that **128**

... pursuant to the investment laws of Peru, the main features of LSAs are that (i) the stabilized legal regimes cannot be changed unilaterally by the State, and (ii) the agreements are subject to private or civil law and not administrative law.²¹⁴

b) In the Absence of Stabilization Clauses

The problem of changes to the chosen law subsequent to the agreement becomes considerably more complex where the parties have not agreed on a stabilization clause. The Convention’s drafting history shows some awareness of the problem but offers no obvious solution. There was some suggestion that subsequent legislation should not apply, at any rate, if it worked to the investor’s detriment (History, Vol. II, pp. 405, 406, 419, 803, 985). On the other hand, the Chairman (Mr. Broches) pointed out that it was up to the parties to decide whether they wanted the chosen law to apply as it prevailed from time to time or whether the investor should receive assurances in this respect as part of the incentives offered to the investor (at p. 502). **129**

In the absence of any reference to the time factor, it is difficult to argue that a choice of the host State’s law is made on the tacit understanding that it only refers to the law as it existed at the time of the agreement.²¹⁵ The more obvious meaning of an agreement on choice of law, unqualified by a stabilization clause, is that the contract is governed by the chosen law subject to later change.²¹⁶ This general principle does not, however, mean that the host State is free to dispose of its contractual obligations through subsequent legislation. A number of authors have suggested that host States are not free to change their law in a manner that would defeat, cancel or gravely affect prior contractual commitments.²¹⁷ **130**

212 At para. 151.

213 *Duke Energy v. Peru*, Decision on Jurisdiction, 1 February 2006, paras. 24–31, 85.

214 At para. 31.

215 But see *Lauterpacht*, The World Bank Convention, pp. 657/8.

216 *Delaume, G. R.*, State Contracts and Transnational Arbitration, 75 AJIL 784 at 805 (1981); *Delaume, Le Centre*, p. 829; *Delaume, G. R.*, Transnational Contracts, Applicable Law and Settlement of Disputes, Ch. XV, 70 (1990); *Delaume, L’affaire*, p. 62; *Giardina*, La legge regolatrice, pp. 685 *et seq.*; *Goldman*, Le droit applicable, pp. 152 *et seq.*; *Hirsch*, The Arbitration Mechanism, p. 124.

217 See *Broches*, The Convention, p. 389; *Curtis*, The Legal Security of Economic Development Agreements, p. 329; *Feuerle*, International Arbitration and Choice of Law, p. 119; *Goldman*, Le droit applicable, p. 153; *Hirsch*, The Arbitration Mechanism, p. 124; *Masood*, Law Applicable, p. 323, and the authorities cited by these authors.

131 It appears that the solution to this problem can only be found by distinguishing between two different types of legislation in terms of their intended and actual effect. Normal changes to the host State's legal system which may be expected in the course of time to adjust to changing social, economic and technological conditions would undoubtedly apply to existing investment arrangements. These would typically include adjustments of labour law, reasonable changes of tax law and the updating of technical safety standards. These *bona fide* evolutions of the local law would have to apply in a non-discriminatory fashion and in a way which does not point towards undeclared secondary purposes. The situation is different with respect to legislation with the declared or undeclared purpose of defeating undertakings which have been freely made by the host State. Action taken through changes in the local law which is designed to strike at the root of the contractual relationship or to create an environment under which the investor can no longer operate need not be accepted. A repudiation of the contract or the confiscatory expropriation of the investor's property through legislative action are obvious examples. The creation of economic conditions designed to force the investor to abandon its operations would also fall into this category. An obvious indicator of impermissible purpose would be legislation directed selectively at a particular investor or group of investors. The host State's freedom to legislate is limited by the minimum standards of protection mandated by international law (see para. 115 *supra*).

132 Under the regime of a bilateral investment treaty, changes in the host State's legislation would be examined primarily against the standard of fair and equitable treatment. The legislative framework existing at the time of the investment will often be the basis for legitimate expectations of the investor. Any drastic change in that framework, that seriously affects the investment, is likely to constitute a breach of the BIT's fair and equitable treatment standard.²¹⁸

B. "In the absence of such agreement, . . ."

133 Before the tribunal may proceed to apply the residual rule contained in the second sentence of Art. 42(1), it must determine that the parties have not agreed on a choice of law. This determination may be made simply by a search of any contractual document which governs their relationship for an explicit choice of law clause, failing which the tribunal may conclude that there is no agreement on choice of law. This was the method adopted in *Benvenuti & Bonfant v. Congo*. After referring to two Articles in agreements between the Parties containing ICSID arbitration clauses, the Tribunal said:

4.2. These Articles do not contain any provision regarding the law applicable. In this case, according to Article 42 (1) of the Convention, the Tribunal applies

²¹⁸ See *e.g.*, *CMS v. Argentina*, Award, 12 May 2005, paras. 274–276; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, paras. 124–133; *PSEG v. Turkey*, Award, 19 January 2007, paras. 240, 250.

the law of the contracting State which is a party to the dispute as well as the principles of international law in the matter.²¹⁹

Another method is to also look for an indirect or implicit choice of law either in the original agreement or in the parties' subsequent conduct. In two cases it was argued that reference to specific items of the host State's legislation in the agreements between the parties amounted to a general choice of its law. The argument was accepted in *LETCO v. Liberia* (see para. 64 *supra*) but the question was left open in *SPP v. Egypt* (see paras. 65, 66 *supra*). In *Autopista v. Venezuela* it was only partially accepted (see para. 68 *supra*). As pointed out above in para. 69, arguments of this kind should be treated with great caution. Yet another way to infer agreement on choice of law is to look at the parties' submissions to the tribunal in the course of the proceedings (see paras. 70–79 *supra*) or at the reliance on a treaty as an indirect choice of law (see paras. 89–95 *supra*). As a general proposition, agreement on choice of law should be proven and not construed (see para. 76 *supra*). Where a clear indication to this effect is lacking, the tribunal should assume absence of such agreement and apply the residual rule. 134

The parties may choose a law that fails to provide an answer to the question before the tribunal. In *SPP v. Egypt* the Tribunal found that lacunae in the law allegedly chosen by the parties amounted to an “absence of agreement” which led to the application of the residual rule of Art. 42(1), second sentence (see paras. 107, 108 *supra*). The choice of a system of domestic law is unlikely to lead to gaps in the chosen law necessitating resort to the residual rule (see para. 109 *supra*). As pointed out in the Dissenting Opinion to the Award,²²⁰ Egyptian law, like other domestic systems, has its own devices to close any perceived gaps. 135

However, choice of law clauses which leave the tribunal without clear direction in a particular situation are indeed feasible. This is particularly so since Art. 42(1) does not mandate the choice of an entire system of law but opens the possibility to choose rules of law selectively (see paras. 39–42 *supra*). In *Wena Hotels v. Egypt*, the Tribunal found that the parties had chosen the BIT as “the primary source of applicable law for this arbitration”. The Tribunal noted that the BIT was a terse document that did not contain all the applicable rules. After quoting Art. 42(1) of the Convention, the Tribunal said: 136

The Tribunal finds that, beyond the provisions of the IPPA [*i.e.* the BIT], there is no special agreement between the parties on the rules of law applicable to the dispute. Rather, the pleadings of both parties indicate that, aside from the provisions of the IPPA, the Tribunal should apply both Egyptian law (*i.e.*, “the law of the Contracting State party to the dispute”) and “such rules of international law as may be applicable”.²²¹

219 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.2. For similar findings see *Cable TV v. St. Kitts and Nevis*, Award, 13 January 1997, para. 6.02; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, paras. 83, 84.

220 *SPP v. Egypt*, Dissenting Opinion, 20 May 1992, 3 ICSID Reports 249, 321.

221 *Wena Hotels v. Egypt*, Award, 8 December 2000, para. 79.

137 Art. 42(2) contains a clear prohibition of *non liquet* (see paras. 245–248 *infra*), thereby forcing the tribunal to come up with a decision even where the rules of law chosen by the parties do not offer a solution. At the same time, Art. 42(3) makes clear that, unless otherwise directed, the tribunal must rest its decision on legal rules and not on equitable considerations (see paras. 260–265 *infra*). In the case of an agreement on rules of law which turn out to be incomplete, the only acceptable avenue for the tribunal is to turn to the residual rule of Art. 42(1), second sentence, to the extent that the law cannot be determined within the framework of the agreed rules. Therefore, resort to the residual rule remains a possible fallback position, even where the parties have made an agreement, although an incomplete one, on choice of law. But this is unlikely to be the case where the parties have chosen an entire legal system since such a choice of law would include the legal system’s rules on closing any gaps (see paras. 246–248 *infra*).

C. “. . . the Tribunal shall apply the law of the Contracting State party to the dispute . . .”

1. The Decision in Favour of the Host State’s Law

138 Earlier versions of what eventually became Art. 42(1) contained no reference to the law of the host State (or “Contracting State party to the dispute”). The Working Paper, the Preliminary Draft and the First Draft provided that, in the absence of an agreement, the tribunal should decide in accordance with such rules of national or (and) international law “as it shall determine to be applicable” (History, Vol. I, pp. 190, 192). The idea behind this somewhat open-ended formula was to let the tribunal find the proper law by applying generally accepted principles of the conflict of laws or private international law (History, Vol. II, pp. 79, 110, 267, 330, 506, 570). As Mr. *Broches* explained, this would lead to the law to which the transaction had the most significant connection. In most cases, this would be the law of the host State, but there would be cases in which other national laws would become applicable (at pp. 514, 571, 800).

139 Some delegates wanted more precision (at pp. 469, 669) and a growing number, especially from capital-importing countries, insisted that only the law of the host country could apply in the absence of agreement between the parties (at pp. 418, 419, 466, 513, 515, 516, 653, 660, 663, 800, 801, 802). In the end, Mr. *Broches* accepted these demands and presented a redrafted version which directed the tribunal to apply the law of the State party to the dispute including its rules on the conflict of laws (at p. 804; see also p. 985). The new draft was adopted by a majority of 35 to 1 (at p. 804; see also p. 939 and *cf.* para. 198 *infra*).²²²

²²² See also *Broches, A.*, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Applicable Law and Default Procedure, *in*: International Arbitration Liber Amicorum for Martin Domke 12, 14, 16 (1967); *Broches*, The Convention, Explanatory Notes and Survey, pp. 667/8; *Chukwumerije*, International Law and Municipal Law, pp. 66/7.

The solution eventually adopted contains a clear decision in favour of the host State's law. The qualifying words at the end of the sentence "as may be applicable" cannot be taken as making this decision contingent on the particular circumstances of the case, since these words do not refer to the law of the Contracting State party to the dispute (see also paras. 201–203 *infra*). Other systems of domestic law are excluded unless their application is mandated by the host State's rules on the conflict of laws.²²³ **140**

This clear victory for the law of the host State is mitigated by four factors: **141**

1. In the vast majority of cases, the host State's law is also the law to which the investment relationship has the closest connection. In other words, it is the law that general principles of the conflict of laws would most likely designate as the proper law anyway.²²⁴

2. The adoption of the host State's law in the second sentence of Art. 42(1) explicitly includes its conflict of laws rules. Therefore, where a particular contractual relationship has stronger connections to the law of another State, the host State's private international law will probably provide for *renvoi* to the law of that other State (see paras. 53–55 *supra*, 161–164 *infra*). It may be expected that the host State's rules on the conflict of laws will usually lead to the same result as the generally accepted principles of the conflict of laws envisaged in the earlier drafts of the Convention.

3. Whenever reliance on the residual rule of Art. 42(1) would lead to unsatisfactory results the parties may avail themselves of the possibility to choose a more appropriate set of rules in accordance with the first sentence of the Article (see also paras. 27–32 *supra*).

4. The host State's law will be subject to the corrective function of international law. If the host State's law is in violation of international law, the latter will provide relief to the investor (see paras. 204–229 *infra*).

The formula contained in Art. 42(1) is not only a careful compromise between the interests of host States and of investors but also strikes a delicate balance between flexibility and predictability. While flexibility is provided by the almost unlimited freedom to agree on a choice of law, the residual rule gives a clear indication of the rules of law that will govern if no such agreement is made. This certainty is a unique feature of the ICSID Convention. Other arbitration rules, such as those of the International Chamber of Commerce (Art. 17(1)),²²⁵ of UNCITRAL **142**

223 See, however, the contrary position taken by *Feuerle*, *International Arbitration and Choice of Law*, pp. 114 *et seq.*

224 *Broches*, A., in: *Liber Amicorum for Martin Domke*, p. 16; *Broches*, *The Convention*, p. 390; *Delaume*, G. R., *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 1 *International Lawyer* 64 at 78 (1966); *Hirsch*, *The Arbitration Mechanism*, p. 133; *Kahn*, *The Law Applicable*, pp. 21 *et seq.*; *Shihata/Parra*, *Applicable Substantive Law*, p. 191.

225 36 ILM 1612 (1979).

(Art. 33(1)),²²⁶ of the American Arbitration Association (Art. 28(1))²²⁷ and of the Iran-US Claims Tribunal (Art. V of the Claims Settlement Declaration),²²⁸ all direct the respective tribunals, in terms, to apply those rules and principles which they determine to be appropriate.²²⁹ Interestingly enough, even the Arbitration Rules governing the ICSID Additional Facility contain a provision that follows the traditional, more open-ended formula:

Article 54

Applicable Law

(1) The Tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the Tribunal shall apply (a) the law determined by the conflict of laws rules which it considers applicable and (b) such rules of international law as the Tribunal considers applicable.

2. *Application of the Host State's Law by ICSID Tribunals*

143 In the absence of an agreed choice of law, ICSID tribunals have not hesitated to turn to the law of the host State. In *Benvenuti & Bonfant v. Congo*, the Tribunal found that since there was no provision regarding the applicable law in the Parties' arbitration clauses, it had to apply Congolese as well as international law (see para. 133 *supra*).²³⁰

144 In *Amco v. Indonesia*, the Tribunal in the original proceedings said after citing Art. 42(1):

148. The parties having not expressed an agreement as to the rules of law according to which the disputes between them should be decided, the Tribunal has to apply Indonesian law, which is the law of the Contracting State Party to the dispute, and such rules of international law as the Tribunal deems to be applicable, considering the matters and issues in dispute.²³¹

145 In *SOABI v. Senegal*, the Tribunal said in relation to Art. 42(1):

In the Tribunal's view, in the absence of agreement between the parties, the national law applicable to the relations of two Senegalese parties in respect of a project that was to take place in Senegal, can only be Senegalese law. The Tribunal is of the opinion that the agreements in question must be characterized as

226 15 ILM 714 (1976).

227 As amended and effective 1 April 1997; <http://www.adr.org>.

228 20 ILM 232 (1981).

229 *Hirsch*, *The Arbitration Mechanism*, pp. 110/1, 132; *Parra, A. R.*, *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multi-lateral Instruments on Investment*, 12 ICSID Review – FILJ 287, 309 (1997); *Shihata/Parra*, *Applicable Substantive Law*, p. 191; *Westberg, J. A.*, *Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation: ICSID and Iran-United States Claims Tribunal Case Law Compared*, 8 ICSID Review – FILJ 5 (1993).

230 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.2. See also *Cable TV v. St. Kitts and Nevis*, Award, 13 January 1997, paras. 6.02, 6.25.

231 *Amco v. Indonesia*, Award, 20 November 1984, para. 148.

“government contracts”, the effect and execution of which are governed primarily by the Code of Governmental Obligations (C.G.O.). It appears from the position of the Government stated in its Counter-Memorial (p. 11) and that of SOABI contained in its Reply (p. 7) that both parties agree that the applicable law is Senegalese administrative law.²³²

The apparent contradiction in this passage containing references to an absence of agreement and to the existence of agreement on choice of law (see also para. 58 *supra*) may be resolved in the following way: the parties had not agreed on a choice of law in accordance with Art. 42(1), first sentence. Once the Tribunal had determined that it had to apply Senegalese law in accordance with the second sentence of Art. 42(1), it found corroboration for the application of Senegalese administrative law in the parties’ submissions. **146**

In *Genin v. Estonia*, the Tribunal restated the rule contained in Art. 42(1). It then concluded that **147**

[i]n the present case, in the absence of any agreement by the parties to the contrary, it is the law of the Republic of Estonia that applies.²³³

Similarly, in *MCI v. Ecuador*, the Tribunal considered that: **148**

it must respect the provisions of the second part of Article 42(1) of the ICSID Convention, i.e., in the absence of an agreement, the Tribunal shall apply Ecuadorian law, including its rules of private international law and such rules of international law as may be applicable.²³⁴

In all these cases, the Tribunals proceeded to examine and apply the respective domestic systems of law.²³⁵ In *Benvenuti & Bonfant v. Congo* and in *SOABI v. Senegal*, the Tribunals also noted that the respective domestic legal systems were heavily influenced by French law and relied on that law as a way of establishing the appropriate rules of the host State’s domestic law.²³⁶ **149**

In *Klöckner v. Cameroon*, the Tribunal determined that it had to apply the law of the Contracting State, that is the civil and commercial law applicable in Cameroon, which in its relevant part (see para. 165 *infra*) is also based on French law.²³⁷ The Tribunal’s subsequent analysis contains some reference to French authorities.²³⁸ Before the *ad hoc* Committee it was argued that the Award should be annulled for manifest excess of powers in the sense of Art. 52(1)(b) of the Convention because of a violation of Art. 42(1). The *ad hoc* Committee had no problem with the Tribunal’s basic finding on the applicable law but held that it had failed to **150**

232 *SOABI v. Senegal*, Award, 25 February 1988, para. 5.02. Footnote omitted.

233 *Genin v. Estonia*, Award, 25 June 2001, para. 350.

234 *MCI v. Ecuador*, Award, 31 July 2007, para. 217.

235 See also *SEMOS v. Mali*, Award, 25 February 2003, 10 ICSID Reports 116, 122–125, where the Tribunal simply applied the law of Mali without a discussion of Art. 42.

236 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, paras. 4.2–4.3; *SOABI v. Senegal*, Award, 25 February 1988, paras. 5.06 *et seq.*, 5.34, 6.15 *et seq.*, 7.13.

237 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 59. For a critical discussion of this issue see *Elombi*, ICSID Awards, pp. 62 *et seq.*

238 At pp. 62 *et seq.*, 66/7, 70/1.

discharge its duty to actually apply that law²³⁹ (see para. 15 *supra*; Art. 52, paras. 234–238).

151 A careful reading of the Award and of the Decision on Annulment suggests that the issue was not a failure to select the correct law nor a material error in the application of that law, a point which the *ad hoc* Committee never addressed, but simply the quality and thoroughness of the reasoning supporting a portion of the Award. The *ad hoc* Committee held that by not providing detailed authority in positive law, the Tribunal had not, in fact, applied the host State's law. Whatever the merits of such a strict standard for the annulment (see paras. 18–20 *supra*), this case is an apt reminder that in applying the host State's law great care must be taken to substantiate any particular findings of law.

152 The situation in *Amco v. Indonesia* was similar in that the *ad hoc* Committee acknowledged that the Tribunal had correctly identified and selected the proper law in accordance with the second sentence of Art. 42(1).²⁴⁰ However, in the *ad hoc* Committee's view, the Tribunal had failed to apply an essential rule of Indonesian law and had thereby exceeded its powers²⁴¹ (see para. 16 *supra*; Art. 52, paras. 227–230).

3. Limits on the Application of the Host State's Law

a) International Law

153 The most important limits on the application of the host State's law arise from the applicable rules of international law and are discussed below at paras. 204–230. These include considerations of international public policy (see paras. 48–52 *supra*) which are not only applicable to cases of choice of law by agreement but also to the application of the host State's law by virtue of the residual rule of Art. 42(1), second sentence.

b) The Host State's Capacity to Submit to Arbitration

154 Other possible limits to the application of the host State's law concern the status and capacity of the parties. Some domestic legal systems contain limitations on the power of the State and of State agencies to enter into arbitration agreements.²⁴² Unlimited reliance on the host State's law as the law applicable to the dispute would support that State's argument that its submission to ICSID arbitration was invalid.²⁴³ One possible solution to this problem is the adoption of a special clause in the agreement between the parties excluding the application of any provision in

239 *Klückner v. Cameroon*, Decision on Annulment, 3 May 1985, paras. 57 *et seq.*

240 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 19.

241 At paras. 93–98.

242 *Delaume*, The Proper Law, pp. 94/5; *Delaume, G. R.*, How to Draft an ICSID Arbitration Clause, 7 ICSID Review – FILJ 168, 169/70 (1992); *Lalive, P.*, L'Etat en tant que partie à des contrats de concession ou d'investissement conclus avec des sociétés privées étrangères, in: 1 New Directions in International Trade Law (*UNIDROIT*) 317 at 326/7 (1977).

243 See *SOABI v. Senegal*, Award, 25 February 1988, paras. 4.54 *et seq.*, Dissenting Opinion, paras. 25 *et seq.*

the host State's law which might cast doubt on its capacity to submit to arbitration (see paras. 34, 46 *supra*). Even in the absence of such a specific provision, the arbitration clause may be read as a special agreement on a rule of law in the sense of the first sentence of Art. 42(1) modifying the otherwise applicable law of the host State.

The more difficult question of the State's capacity to contract in violation of its own law (see paras. 46, 47 *supra*) is likely to involve the interplay of domestic and international law (see paras. 204–244 *infra*). The principles of good faith and of estoppel would strongly suggest that a State cannot rely on its own law to extricate itself from contractual commitments to the investor.²⁴⁴ In addition, Art. 25(1), second sentence, provides that a party may not withdraw its consent unilaterally. It follows that a State cannot rely on a provision of its domestic law to defeat its consent to arbitration (see also paras. 4–8 *supra*; Art. 25, paras. 625–632).

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In *Autopista v. Venezuela*, the Respondent argued that Venezuelan law did not allow the submission of a dispute concerning the termination of a concession contract to arbitration. The Tribunal rejected this argument as belated.²⁴⁵ It added the following observation:

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Moreover, a jurisdictional challenge based on an alleged exclusive jurisdiction of a Venezuelan authority would also violate the well-established principle of international law pursuant to which a state cannot rely on its domestic legislation to renege on a contractual obligation to resort to arbitration.²⁴⁶

c) *The Investor's Legal Status*

Another situation in which the application of the host State's law must be qualified concerns the status of the investor. The legal status and capacity of the foreign investor is not subject to the control of the host State's law but is governed by the law of the State of incorporation.²⁴⁷

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In *Amco v. Indonesia* (see Art. 25, para. 341), the Claimant, a company registered in Delaware, was dissolved under the laws of Delaware approximately one month after the rendering of the first Award. Indonesia argued that under Indonesian law, which was applicable by virtue of Art. 42(1), second sentence, once a limited liability corporation is dissolved, it ceases to exist for any purpose.²⁴⁸ The Tribunal disagreed with Indonesia's argument on applicable law:

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When a company enters into an agreement with a foreign legal person, the legal status and capacity of that company is determined by the law of the state of incorporation. Similarly, one should apply the law of the state of incorporation to determine whether such a company, though dissolved, is still an existing legal entity for any specified legal purpose.

244 See *Schwabel, S. M.*, International Arbitration: Three Salient Problems 68 *et seq.* (1987) and the authorities cited there.

245 *Autopista v. Venezuela*, Award, 23 September 2003, paras. 89, 90, 206.

246 At para. 91. See also para. 207. The Tribunal relied on the First Edition of this Commentary.

247 See also *Noble Energy v. Ecuador*, Decision on Jurisdiction, 5 March 2008, paras. 87–89.

248 *Amco v. Indonesia*, Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 561.

The dissolution of Amco Asia was governed by the law of the state of Delaware. Under Delaware law Amco Asia remains a juridical entity for purposes of any action, suit or proceeding begun by or against it prior to or within three years of dissolution or until such action, suit or proceeding is completed and any judgment, order or decree therein is executed (Section 278, Delaware General Corporation Law).²⁴⁹

159 In *Scimitar v. Bangladesh* the Respondents objected to jurisdiction on the ground that proceedings had been instituted by persons not competent to act for the Claimant. The Claimant was a company established under the laws of the British Virgin Islands. The Tribunal said:

It is the joint position of the Parties that the law applicable to the question of corporate transactions and governance is the law of the British Virgin Islands. Upon its own review of applicable law, the Tribunal sees no reason to depart from this position, which is consonant with Article 42 [of the ICSID Convention]. . . . The Tribunal has also examined the question of corporate authorization under the law of the British Virgin islands, which is that proceedings initiated by a corporation without proper corporate authority or authorization are invalid.²⁵⁰

Therefore, the Tribunal found that the law governing corporate transactions and governance was the law under which the company had been established. On that basis the Tribunal found that the dispute was not within the jurisdiction of ICSID.²⁵¹

4. Subsequent Changes in the Host State's Law

160 Most of what has been said about a subsequent change by the host State of its law in the context of the first sentence of Art. 42(1) (see paras. 116–132 *supra*) is equally valid where that law is applicable by virtue of the residual rule of the second sentence. In principle, the host State's law will be applicable as it evolves over time; that is, subject to any changes that may occur after the establishment of the investment relationship. Stabilization clauses (see paras. 117–128 *supra*) are less likely where the parties have not addressed the question of choice of law. Nevertheless, they would have to be respected also in the context of the residual rule. In the more likely case of an absence of a stabilization clause, one would have to distinguish between routine adjustments of the host State's law and changes which fundamentally affect an investment agreement between the parties (see paras. 129–132 *supra*) or otherwise encroach upon rights of the investor protected by international law. Changes of the former kind would have to be accepted by the investor, whereas changes of the latter kind would give rise to the host State's responsibility. However, there is an important difference in this respect between the first and second sentence of Art. 42(1). The problems encountered where an agreed choice of law does not include reference to international law (see paras.

²⁴⁹ At p. 562.

²⁵⁰ *Scimitar v. Bangladesh*, Award, 5 April 1994, paras. 26, 28.

²⁵¹ At para. 29.

104–115 *supra*) would not arise here. Under the residual rule of Art. 42(1), the tribunal is instructed to apply the law of the Contracting State party in conjunction with international law. As set out below (see paras. 204–244), any alteration of the host State’s law which is in violation of international law would lead an ICSID tribunal to hold that State liable for a breach of its obligations.

D. “. . . (including its rules on the conflict of laws) . . .”

The earlier drafts to the Convention had not provided for the application of the host State’s law in the absence of agreement on choice of law but had foreseen a wide discretion for the tribunal to apply such rules of law as it would determine to be applicable (History, Vol. I, pp. 190–192). The expectation was that, in exercising this discretion, a tribunal would apply generally accepted principles on the conflict of laws (see paras. 138–140 *supra*). When, under mounting pressure, especially from representatives of capital importing countries, the draft was changed to refer the tribunal to the host State’s law, a reference to that State’s rules on private international law was added (History, Vol. II, p. 804). The idea was to take some of the rigidity out of the automatic reference to the host State’s law in case another system of law has stronger contacts to the transaction and a court of the host State would apply that other system of law.²⁵² It is this origin in the Convention’s drafting history which explains the highly unusual phenomenon of a choice of law clause containing a reference to the conflict rules of the chosen law.²⁵³ Typical situations where a law other than that of the host State would turn out to be the proper law would be commercial loan contracts or licensing agreements²⁵⁴ (see paras. 27–32 *supra*).

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The *renvoi* provision of the second sentence of Art. 42(1) constitutes an important difference to the rule on agreed choice of law in the first sentence. While the difference may be explained in the technicalities of the drafting of Art. 42(1) (see para. 54 *supra*), there is a strong presumption that an agreed choice of law would only refer to the chosen law’s substantive provisions (see para. 55 *supra*). The residual rule clearly directs the tribunal to take the host State’s own rules on the conflict of laws into account. A tribunal, after having determined that there is no agreement on choice of law, would, therefore, first have to examine the host State’s private international law. Only after establishing that these rules do not refer to another system of law may the tribunal proceed to apply the host State’s substantive law.

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The original Award in *Amco v. Indonesia* contains some reference to this process. After noting that the parties had not agreed on a choice of law and that, therefore, the second sentence of Art. 42(1) had to be applied (see para. 144 *supra*), the Tribunal said:

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252 *Broches*, Convention, Explanatory Notes and Survey, p. 668.

253 *Cf. Delaume*, *Le Centre*, p. 828; *Delaume*, *L’affaire*, p. 52.

254 *Delaume, G. R.*, Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 1 *International Lawyer* 64 at 79 (1966).

As to Indonesian law, there is no need to enter into a discussion of its conflicts of laws' rules. Indeed, Claimants as well as Respondent were constantly referring, in their discussion on the merits to the substantive law of Indonesia. Moreover, the dispute before the Tribunal relating to an investment in Indonesia, there is no doubt that the substantive municipal rules of law to be applied by the Tribunal are to [be] drawn from Indonesian law.²⁵⁵

164 There is no doubt that the flexibility provided by the *renvoi* clause of Art. 42(1) somewhat detracts from the predictability achieved through the reference to the host State's law.²⁵⁶ One possible outcome is that the host State's conflict rules might refer the tribunal to another State's law for certain aspects of the dispute but not for others. While this may appear an unnecessary complication, it is a normal result of private international law rules before domestic courts. Of course, the *renvoi* clause is subject to variation or exclusion by agreement of the parties.

165 The only case in which conflict of laws rules of the host State have become relevant involved circumstances which were most probably not in the minds of the drafters of the Convention. In *Klöckner v. Cameroon* there was no agreement on choice of law. Therefore, the second sentence of Art. 42(1) became operative directing the Tribunal to apply the law of Cameroon. As a consequence of its colonial heritage, Cameroon continues to apply two different systems of law, common law in the former British Cameroon and the French Civil Code in the previously French part. The Tribunal accepted the Claimant's position that only French law should be applied to the dispute. It noted that the factory project's location and the place where the agreements between the parties were finalized both pointed towards that part of Cameroonian law which was based on French law.²⁵⁷ The Tribunal proceeded to analyse the merits of the case primarily by reference to French law.²⁵⁸ However, some uncertainty seems to have lingered in the Tribunal's mind. At one point in its analysis it said:

In view of the parties' divergence of views as to applicable law under Article 42 of the ICSID Convention, it is appropriate to remark that English law and international law reach similar conclusions.²⁵⁹

After citing an English law and an international law authority, the Tribunal reverts to its analysis in the light of French law.

166 Despite some reserve that has been expressed towards this use of the *renvoi* rule for choice of law questions arising within a State,²⁶⁰ the Tribunal's approach

255 *Amco v. Indonesia*, Award, 20 November 1984, para. 148. This reasoning of the *Amco* Tribunal was expressly endorsed by the Tribunal in *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 87.

256 See esp. *Kahn*, *The Law Applicable*, pp. 24 *et seq.*, who is highly critical of the *renvoi* provision. Cf. also *Giardina*, *La legge regolatrice*, pp. 690 *et seq.*

257 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 59.

258 At pp. 61–64, 71/2.

259 At p. 63. See also *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 168.

260 *Delaume, G. R.*, *Transnational Contracts, Applicable Law and Settlement of Disputes*, Ch. XV, 67/8 (1990); *Delaume*, *L'affaire*, p. 52; *Hirsch*, *The Arbitration Mechanism*, pp. 134/5.

appears eminently reasonable. What matters in choice of law questions is not political organization but law districts, whether they coincide with a State's boundaries or not. This would have to apply whether the country concerned has a federal structure or not. If the Contracting State party to the dispute were to be the United States, it would make some difference whether the applicable law is that of Delaware or of Louisiana. If the State concerned is the United Kingdom, it would be necessary to clarify whether English or Scottish law is to be applied.

E. "... and such rules of international law ..."

1. Rules or Principles of International Law

This passage of Art. 42(1) contains a curious discrepancy between the English and Spanish texts of the Convention on one side and the French text on the other. Whereas the English text speaks of "rules of international law" (Spanish "normas de derecho internacional"), the French text speaks of "principes de droit international" which would be better translated as "principles of international law" and would indicate a higher level of generality and abstraction. Even Mr. Broches found the difference hard to explain in view of the joint sessions of the trilingual drafting committee.²⁶¹ The mystery is compounded by the fact that the English text of Art. 42(1) contains the word "rules" three times which in the French text is rendered as "règles" twice but as "principes" on the third occasion. The Spanish text is consistent in the use of the word "normas". A look at the drafting history of the French text shows that it initially contained the word "règle" also in reference to international law but that this was changed to "principes" in the Revised Draft for no apparent reason (History, Vol. I, pp. 190–191). This background would indicate that the French term "principes" should not be accorded any particular significance and should not be used to exclude the application of specific rules.²⁶²

The difference between rules and principles of international law does not seem to have created major difficulties for tribunals. However, in *Klöckner v. Cameroon*, the *ad hoc* Committee, writing in French, seemed to be unaware of any version of the Convention other than the French one. In castigating the Tribunal for applying what it assumed to be a basic principle of French law, it notes that Art. 42(1) itself distinguishes between the concepts of "rules of law" and "principles of law".²⁶³ It continues to speculate that the Tribunal might have confused the "principles of international law" referred to in Art. 42(1) with the "general principles of law recognized by civilized nations" in the sense of Art. 38 of the Statute of the International Court of Justice²⁶⁴ (see paras. 178–182 *infra*).

261 Broches, The Convention, p. 391.

262 Broches, *loc. cit.*; see also the Dissenting Opinion to the Award in *SPP v. Egypt*, 2 May 1992, 3 ICSID Reports 326.

263 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 68.

264 At para. 69.

2. *Finding the Rules of International Law*

169 Reference to rules of international law was contained in all drafts of the Convention, although their inclusion was by no means uncontested (see para. 198 *infra*). There was repeated concern that the mere reference to rules of international law was too unspecific and required further elaboration (History, Vol. II, pp. 330, 418, 570, 801). Suggestions to clarify the contents of “rules of international law” by reference to the established sources of international law (at p. 418) led to a definition in the First Draft of the Convention which specifically refers to Art. 38(1) of the Statute of the International Court of Justice (History, Vol. I, p. 192; Vol. II, p. 802). This definition was later transferred from the text of the Convention to the Report of the Executive Directors (History, Vol. II, pp. 962, 1029). Its para. 40 runs in part:

The term “international law” as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice, allowance being made for the fact that Article 38 was designed to apply to inter-State disputes.²⁶⁵

170 The reference to the enumeration of sources of international law as contained in Art. 38(1) of the ICJ Statute by no means resolves the problem of establishing the rules of international law relevant to the particular dispute. It is debatable whether the list provided there paints a complete picture of contemporary international law and whether the neat categories suggested there conform to the complex realities of international legal practice. Nevertheless, this reference demonstrates that an ICSID tribunal is directed to look at the full range of sources of international law in a similar way as the International Court of Justice²⁶⁶ (see also paras. 192–203 *infra*).

a) Treaties

171 There can be no doubt that treaty law is an important aspect of international law to be applied by ICSID tribunals. First and foremost among treaties would be bilateral investment treaties (BITs) between the host State and the home State of the investor. In addition, a number of multilateral treaties such as the NAFTA,

²⁶⁵ The following footnote is attached to the Report of the Executive Directors:

Article 38(1) of the Statute of the International Court of Justice reads as follows:

“1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
- b. international custom, as evidence of a general practice accepted as law;
- c. the general principles of law recognized by civilized nations;
- d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules law.”

²⁶⁶ *Kahn*, *The Law Applicable*, pp. 28 *et seq.*

the Energy Charter Treaty and the MERCOSUR Investment Protocols (see paras. 85, 86 *supra*; Art. 25, paras. 457–463) contain detailed rules concerning foreign investment. These treaties are specifically designed to govern the type of relationship that is likely to come before an ICSID tribunal. It is also clear from the Convention’s drafting history that BITs were meant to be included among the “rules of international law” of Art. 42(1) (History, Vol. II, p. 984). The large and rapidly growing number of BITs²⁶⁷ and multilateral treaties dealing with investment makes them the most important source of international law for ICSID tribunals.

AAPL v. Sri Lanka was the first case in which consent to jurisdiction was based on a BIT. The Tribunal also accepted the Sri Lanka/United Kingdom BIT as the primary source of the applicable legal rules.²⁶⁸ Although the Tribunal reached this result by construing an implied agreement of the parties through their conduct before the Tribunal (see paras. 60, 61, 70 *supra*), there can be no doubt that the Treaty would have constituted the main source of the rules of international law also under the residual rule of Art. 42(1), second sentence. Ever since that case, reliance on BITs has become a routine feature of numerous ICSID cases. In the majority of contemporary cases, a BIT is the centrepiece of the law applied by tribunals.

Other treaties may also become relevant in ICSID arbitration.²⁶⁹ In particular, the Vienna Convention on the Law of Treaties is frequently applied by tribunals, especially when interpreting BITs.²⁷⁰ Human rights treaties have been invoked occasionally before ICSID tribunals but without notable success.²⁷¹

In *SPP v. Egypt*, Egypt argued that the cancellation of a tourism project was required by the 1972 UNESCO Convention for the Protection of the World Cultural and Natural Heritage. The Tribunal declared the question of whether the parties

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267 *Laviee, J.-P.*, Protection et Promotion des Investissements (1985); United Nations Centre on Transnational Corporations: Bilateral Investment Treaties (1988 with 1992 supplement); The World Bank: Legal Framework for the Treatment of Foreign Investment, Vol. I, Survey of Existing Instruments (1992); *Dolzer, R./Stevens, M.*, Bilateral Investment Treaties (1995); Investment Treaties (ICSID ed.) loose-leaf collection.

268 *AAPL v. Sri Lanka*, Award, 27 June 1990, para. 20.

269 See *Hirsch, M.*, Interactions between Investment and Non-Investment Obligations, in: The Oxford Handbook of International Investment Law (*Muchlinski, P./Ortino, F./Schreuer, C.* eds.) 154 (2008).

270 See e.g., *AAPL v. Sri Lanka*, Award, 27 June 1990, paras. 38–42; *Tokios Tokelés v. Ukraine*, Decision on Jurisdiction, 29 April 2004, para. 27; *MTD v. Chile*, Award, 25 May 2004, para. 112; *Enron v. Argentina*, Decision on Jurisdiction (Anc. Claim), 2 August 2004, para. 32; *Siemens v. Argentina*, Decision on Jurisdiction, 3 August 2004, para. 80; *Salini v. Jordan*, Decision on Jurisdiction, 29 November 2004, para. 75; *Plama v. Bulgaria*, Decision on Jurisdiction, 8 February 2005, paras. 117, 147–165; *Sempra v. Argentina*, Decision on Jurisdiction, 11 May 2005, para. 141; *Camuzzi v. Argentina*, Decision on Jurisdiction, 11 May 2005, para. 133; *Noble Ventures v. Romania*, Award, 12 October 2005, para. 50; *Aguas del Tunari v. Bolivia*, Decision on Jurisdiction, 21 October 2005, paras. 88–93, 226, 230, 239; *Fraport v. Philippines*, Award, 16 August 2007, para. 339.

271 *CMS v. Argentina*, Award, 12 May 2005, paras. 114, 121; *Azurix v. Argentina*, Award, 14 July 2006, paras. 254, 261; *Siemens v. Argentina*, Award, 6 February 2007, paras. 75, 79.

had made an agreed choice of law in favour of Egyptian law immaterial, holding that the UNESCO Convention and general international law would be applicable either way²⁷² (see paras. 65, 66, 107, 108 *supra*). It came to the conclusion that the UNESCO Convention did not justify the measures taken by the Respondent and did not exclude the Claimant's right to compensation. This was primarily so because it was not until some time after the project's cancellation that the area in question was registered in the inventory of property to be protected by the UNESCO Convention. On the other hand, the concern for the antiquities was accepted as genuine.²⁷³

b) Customary International Law

175 Customary international law offers important guidance in investment disputes. Its rules on the minimum standard for the treatment of aliens including their property, more specifically on expropriation and compensation, on the prohibition of denial of justice and on State responsibility for injury to aliens are obvious examples.²⁷⁴ In the course of the Convention's drafting, a number of suggestions were made concerning possible rules of international law that might be applied by tribunals. These included protection against discriminatory treatment, the obligation to act in good faith, the prohibition of measures contrary to international public policy, *pacta sunt servanda*, the exhaustion of local remedies and rules on State succession (History, Vol. II, pp. 419, 570, 801, 985). Mr. *Broches* pointed out that the reference to international law in Art. 42 comprised, apart from treaty law, only such principles as that of good faith and the principle that one ought to abide by agreements voluntarily made and ought to carry them out in good faith (at p. 985).

176 ICSID tribunals have affirmed in the context of Art. 42(1) that "applying the rules of international law is to be understood as comprising the general international law, including customary international law [. . .]".²⁷⁵

177 ICSID tribunals have frequently applied rules of customary international law either under the first or second sentence of Art. 42(1). This practice may be illustrated by the following examples:

- principles of State responsibility;²⁷⁶
- the principle of respect for acquired rights;²⁷⁷

272 *SPP v. Egypt*, Award, 20 May 1992, paras. 75–78.

273 At paras. 150–159.

274 For a more elaborate analysis see *Firth*, *The Law Governing Contracts*, pp. 262 *et seq.*

275 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 89. See also *ADC v. Hungary*, Award, 2 October 2006, para. 290.

276 *SPP v. Egypt*, Award, 20 May 1992, para. 85; *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 108; *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, para. 102; *Jan de Nul v. Egypt*, Decision on Jurisdiction, 16 June 2006, para. 89; *Azurix v. Argentina*, Award, 14 July 2006, para. 50; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, para. 148; *Kardassopoulos v. Georgia*, Decision on Jurisdiction, 6 July 2007, para. 190.

277 *Amco v. Indonesia*, Award, 20 November 1984, para. 248(v).

- consequences of a state of necessity;²⁷⁸
- denial of justice;²⁷⁹
- the standard of protection in case of an insurrection;²⁸⁰
- nationalization in breach of a stabilization clause;²⁸¹
- expropriation requires compensation;²⁸²
- the *Chorzów Factory* standard²⁸³ providing the appropriate measure of compensation for wrongful expropriation;²⁸⁴
- a lawful nationalization requires a legislative enactment, taken for a *bona fide* public purpose, non-discrimination and appropriate compensation;²⁸⁵
- not only tangible property rights but also contractual rights may be indirectly expropriated;²⁸⁶
- jurisdiction is determined by reference to the date on which proceedings are instituted;²⁸⁷
- is there a requirement to exhaust local remedies?²⁸⁸
- is it permissible to pierce the corporate veil to determine jurisdiction?²⁸⁹
- are shareholders protected under general international law?²⁹⁰

c) General Principles of Law

Under prevailing theory and practice, general principles of law are found through a process of comparative law whereby features common to domestic

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- 278 *CMS v. Argentina*, Award, 12 May 2005, paras. 304–331; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, paras. 245–266; *Enron v. Argentina*, Award, 22 May 2007, paras. 294–313; *CMS v. Argentina*, Decision on Annulment, 25 September 2007, paras. 101–150; *Sempra v. Argentina*, Award, 28 September 2007, paras. 333–354, 392–397.
- 279 *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, paras. 122–138.
- 280 *AAPL v. Sri Lanka*, Award, 27 June 1990, para. 72.
- 281 *AGIP v. Congo*, Award, 30 November 1979, paras. 84–88.
- 282 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.64; *Amco v. Indonesia*, Award, 20 November 1984, para. 188; *Santa Elena v. Costa Rica*, Award, 17 February 2000, paras. 68–95.
- 283 *Case Concerning the Factory at Chorzów*, Judgment No. 13, 13 September 1928, Merits, 1928, P.C.I.J., Series A, No. 17, p. 47.
- 284 *Vivendi v. Argentina*, Resubmitted Case: Award, 20 August 2007, paras. 8.2.2–8.2.7.
- 285 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 366.
- 286 *SPP v. Egypt*, Award, 20 May 1992, paras. 160–168.
- 287 *Goetz v. Burundi*, Award, 10 February 1999, para. 72; *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, para. 31; *Bayindir v. Pakistan*, Decision on Jurisdiction, 14 November 2005, para. 178; *Vivendi v. Argentina*, Resubmitted Case: Decision on Jurisdiction, 14 November 2005, paras. 60, 63; *El Paso v. Argentina*, Decision on Jurisdiction, 27 April 2006, paras. 117–136; *Enron v. Argentina*, Award, 22 May 2007, para. 396.
- 288 *Maffezini v. Spain*, Decision on Jurisdiction, 25 January 2000, paras. 28 *et seq.*; *Generation Ukraine v. Ukraine*, Award, 16 September 2003, paras. 13.1–13.6; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, paras. 150–153.
- 289 *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, paras. 53–56.
- 290 *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 48; *Camuzzi v. Argentina I*, Decision on Jurisdiction, 11 May 2005, paras. 144, 145; *Sempra v. Argentina*, Decision on Jurisdiction, 11 May 2005, paras. 156, 157.

legal systems are established. Although formally equivalent to treaty and custom, they are frequently used to fill gaps left by these two sources. Since treaties and custom are created through the interaction of States, general principles of law are particularly useful in areas of the law which involve non-State actors such as investment relationships. They have played a prominent role in arbitrations between States and foreign nationals²⁹¹ as is aptly illustrated by the practice of the Iran-US Claims Tribunal.²⁹² General principles of law are an important source of international law also in ICSID cases.²⁹³ Typically, they involve questions of a less political and more technical character than rules of customary international law.

179 In *Inceysa v. El Salvador*, the Tribunal, after quoting Art. 38 of the Statute of the International Court of Justice, described general principles of law as follows:

226. According to the precept transcribed above, the general principles of law are an autonomous or direct source of International Law, along with international conventions and custom.

227. Without attempting to define what the general principles of law are, the Tribunal notes that, in general, they have been understood as general rules on which there is international consensus to consider them as universal standards and rules of conduct that must always be applied and which, in the opinion of important commentators, are rules of law on which the legal systems of the States are based.²⁹⁴

180 The practice of ICSID tribunals on general principles of law may be illustrated by the following examples:

- good faith;²⁹⁵
- prohibition of corruption;²⁹⁶
- nobody can benefit from his or her own fraud (*nemo auditur propriam turpitudinem allegans*);²⁹⁷

291 *Curtis*, The Legal Security of Economic Development Agreements, pp. 331 *et seq.*; *Kahn, P.*, Les principes généraux du droit devant les arbitres du commerce international, 116 *Journal du Droit International* 305 (1989); *Lipstein, K.*, International Arbitration between Individuals and Governments and the Conflict of Laws, *in*: Contemporary Problems of International Law: Essays in Honour of Georg Schwarzenberger 177 (1988); *Lillich, R. B.*, The Law Governing Disputes, pp. 107 *et seq.* (1993).

292 *Hanessian, G.*, “General Principles of Law” in the Iran-U.S. Claims Tribunal, 27 *Columbia J. Transnat’l L.* 309 (1989).

293 *Cherian*, Investment Contracts, pp. 90 *et seq.*; *Gaillard, E.*, Centre International pour le Règlement des Différends relatifs aux Investissements (CIRDI). Chronique des sentences arbitrales, 114 *Journal du Droit International* 135, 159 (1987).

294 *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 226, 227.

295 *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, para. 47; *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 230 *et seq.*

296 *Wena Hotels v. Egypt*, Award, 8 December 2000, para. 111; *World Duty Free v. Kenya*, Award, 4 October 2006, paras. 138–157.

297 *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 240 *et seq.*

- general principles of contract law²⁹⁸ including *pacta sunt servanda*²⁹⁹ and the *exceptio non adimpleti contractus*;³⁰⁰
- estoppel;³⁰¹
- unjust enrichment;³⁰²
- full compensation of prejudice resulting from a failure to fulfil contractual obligations;³⁰³
- the principle of compensation in case of nationalization;³⁰⁴
- general principles of due process;³⁰⁵
- the claimant bears the burden of proof;³⁰⁶
- *res judicata*;³⁰⁷
- prohibition of abuse of right;³⁰⁸
- the duty to mitigate damage;³⁰⁹
- no one can transfer a better title than he or she has (*nemo plus iuris transferre potest quam ipse habet*);³¹⁰
- valuation of damages.³¹¹

298 *Amco v. Indonesia*, Award, 20 November 1984, paras. 180–183.

299 *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, para. 4.3; *Amco v. Indonesia*, Award, 20 November 1984, paras. 248 *et seq.* Cf. also Toope, S. J., Mixed International Arbitration: Studies in Arbitration Between States and Private Persons 241 *et seq.* (1990).

300 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 61 *et seq.*; *Autopista v. Venezuela*, Award, 23 September 2003, para. 316.

301 *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, para. 47; *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, paras. 144–145; *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 123; *SPP v. Egypt*, Decision on Jurisdiction I, 27 November 1985, para. 63; *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, para. 47; *Gruslin v. Malaysia*, Award, 27 November 2000, paras. 20.1–20.5; *Zhinvali v. Georgia*, Award, 24 January 2003, paras. 244–248; *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, paras. 122, 175–177; *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, para. 109; *Pan American v. Argentina*, Decision on Jurisdiction, 27 July 2006, paras. 140–161; *ADC v. Hungary*, Award, 2 October 2006, paras. 474, 475; *Fraport v. Philippines*, Award, 16 August 2007, paras. 346, 347.

302 *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, paras. 154–156; *SPP v. Egypt*, Award, 20 May 1992, paras. 245–249; *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 253 *et seq.*

303 *Amco v. Indonesia*, Award, 20 November 1984, paras. 265–268.

304 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.64.

305 *Amco v. Indonesia*, Award, 20 November 1984, paras. 199–201; *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, paras. 75–79.

306 *AAPL v. Sri Lanka*, Award, 27 June 1990, para. 56; *Tradex v. Albania*, Award, 29 April 1999, para. 74; *Middle East Cement v. Egypt*, Award, 12 April 2002, para. 89; *Generation Ukraine v. Ukraine*, Award, 16 September 2003, paras. 19.1, 19.4; *Noble Ventures v. Romania*, Award, 12 October 2005, para. 100; *Salini v. Jordan*, Award, 31 January 2006, paras. 70–75; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, para. 83; *Tokios Tokelès v. Ukraine*, Award, 26 July 2007, para. 121.

307 *Amco v. Indonesia*, Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 ICSID Reports 548 *et seq.*

308 *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, paras. 154–158; *Siag v. Egypt*, Decision on Jurisdiction, 11 April 2007, paras. 119, 125, 213.

309 *Middle East Cement v. Egypt*, Award, 12 April 2002, para. 167.

310 *Mihaly v. Sri Lanka*, Award, 15 March 2002, para. 24.

311 *Amco v. Indonesia*, Award, 20 November 1984, para. 267; *Fedax v. Venezuela*, Award, 9 March 1998, para. 30; *Enron v. Argentina*, Award, 22 May 2007, para. 360.

- 181** Before applying presumed general principles of law, great care must be taken to establish these principles by inductive proof and not simply to assume or postulate their existence. In *Klöckner v. Cameroon*, the Tribunal, while purporting to apply domestic law, added that a “duty of full disclosure to a partner in a contract” was not only a principle of French civil law but that this was “indeed the case under the other national codes which we know of” and that this was the criterion which “applies to relations between partners in simple forms of association anywhere”³¹² (see also paras. 15, 150 *supra*). The *ad hoc* Committee took these allusions as a reference to general principles of law.³¹³ In annulling the Award, it deplored the absence of any authority for these general principles or universal requirements³¹⁴ and concluded that the Award’s reasoning seemed more like a simple reference to equity³¹⁵ (see paras. 262, 263 *infra*).
- 182** It is important to remember that general principles of law are not a substitute for decisions *ex aequo et bono* provided for in Art. 42(3). These would require specific consent (see paras. 260–265 *infra*). General principles of law are not an expression of general feelings of justice or equity but are part of the body of international law which, in a particular case, must be proven and not presumed. This proof must be furnished on the basis of a rigorous examination, if not of all systems of law at least of the most important major representative systems.

d) Judicial Decisions

- 183** At one point in the Convention’s drafting, concerns about the scarcity or lack of clarity of rules of international law which might have to be applied by ICSID tribunals led to a suggestion to obtain the authorization by the UN General Assembly for ICSID tribunals to seek advisory opinions from the International Court of Justice (History, Vol. II, p. 420). For practical reasons this idea was not pursued. However, ICSID tribunals have relied heavily on previous international judicial decisions as authority when dealing with questions of international law. References to international adjudication include decisions of the Permanent Court of International Justice and of the International Court of Justice, of the European Court of Human Rights, the Iran-US Claims Tribunal and other courts and arbitral tribunals.³¹⁶
- 184** Reference to previous ICSID decisions has become a standard feature in most decisions of ICSID tribunals (see also Art. 53, paras. 16, 17).³¹⁷ Tribunals regularly rely on other ICSID decisions and awards to the extent that they find their reasoning persuasive.³¹⁸ At times they disregard earlier decisions and voice their

312 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 59.

313 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 69.

314 At para. 72.

315 At para. 77.

316 For a comprehensive survey of citations see *Commission, J. P.*, Precedent in Investment Treaty Arbitration – A Citation Analysis of a Developing Jurisprudence, 24 *Journal of International Arbitration* 129–158 (2007).

317 For a comprehensive survey see *Commission, op. cit.*

318 See *Bjorklund, A.*, Investment Treaty Arbitral Decisions as *Jurisprudence Constante*, in: *International Economic Law: The State and Future of the Discipline* (*Picker, C./Bunn, I./Arner, D.*

disagreement.³¹⁹ While it is clear that ICSID tribunals are not legally “bound by any other judgments or arbitral awards”³²⁰ and that “the decisions of ICSID tribunals are not binding precedents”.³²¹ tribunals have generally tried to interpret similar issues in a similar way attempting to establish a coherent body of law.³²² The notion of a “common legal opinion or *jurisprudence constante*” first used by the Tribunal in *SGS v. Philippines*³²³ was espoused by the Tribunal in *AES v. Argentina* which spoke of the ICSID *de facto* case-law as the contribution “to the development of a common legal opinion or *jurisprudence constante*, to resolve some difficult legal issues discussed in many cases, inasmuch as these issues share the same substantial features”.³²⁴

In *Gas Natural v. Argentina*, the Tribunal took an unusually cautious attitude towards “precedents”. It first gave its Decision on Jurisdiction “independently, without considering itself bound by any other judgments or arbitral awards”. Only after having reached a result, the Tribunal added that it would be useful to compare its conclusions with the conclusions reached in other ICSID arbitrations.³²⁵

In *ADC v. Hungary* the Tribunal summarized the practice of ICSID tribunals by stating that “cautious reliance on certain principles developed in a number of those cases, as persuasive authority, may advance the body of law, which in turn may serve predictability in the interest of both investors and host States”.³²⁶

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eds. 2008); *Cheng, T.*, Precedent and Control in Investment Treaty Arbitration, 30 *Fordham International Law Journal* 1014 (2007); *Kaufmann-Kohler, G.*, Arbitral Precedent: Dream, Necessity, or Excuse, 23 *Arbitration International* 357 (2007); *Paulsson, J.*, International Arbitration and the Generation of Legal Norms: Treaty Arbitration and International Law, TDM September 2006; *Reinisch, A.*, The Role of Precedent in ICSID Arbitration, in: *Austrian Arbitration Yearbook* 495 (2008); *Schreuer, C.*, Diversity and Harmonization of Treaty Interpretation in Investment Arbitration, TDM, Vol. 3, #2, April 2006; *Schreuer, C./Weiniger, M.*, A Doctrine of Precedent?, in: *The Oxford Handbook of International Investment Law* (*Muchlinski, P./Ortino, F./Schreuer, C.* eds.) 1188 (2008); *Shahabuddeen, M.*, Precedent in the World Court (1996); *Banifatemi, Y.* (ed.), *Precedent in International Arbitration* (2008).

319 See e.g., *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, paras. 97, 128, 134; *Plama v. Bulgaria*, Decision on Jurisdiction, 8 February 2005, paras. 216–226; *El Paso v. Argentina*, Decision on Jurisdiction, 27 April 2006, paras. 75, 76. See also *Franck, S. D.*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 *Fordham Law Review* 1521 (2005).

320 *Gas Natural v. Argentina*, Decision on Jurisdiction, 17 June 2005, para. 36.

321 *Enron v. Argentina*, Decision on Jurisdiction (Ancillary Claim), 2 August 2004, para. 25, cited in *AES v. Argentina*, Decision on Jurisdiction, 26 April 2005, para. 23. See also *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 352; *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 44.

322 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 352; *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 44; *El Paso v. Argentina*, Decision on Jurisdiction, 27 April 2006, para. 39; *Suez v. Argentina*, Decision on Jurisdiction, 16 May 2006, paras. 26, 31, 60–65; *Jan de Nul v. Egypt*, Decision on Jurisdiction, 16 June 2006, paras. 63, 64; *Azurix v. Argentina*, Award, 14 July 2006, para. 391; *Pan American v. Argentina*, Decision on Preliminary Objections, 27 July 2006, para. 42.

323 *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, para. 97.

324 *AES v. Argentina*, Decision on Jurisdiction, 26 April 2005, para. 33.

325 *Gas Natural v. Argentina*, Decision on Jurisdiction, 17 June 2005, paras. 36, 52.

326 *ADC v. Hungary*, Award, 2 October 2006, para. 293.

187 The Tribunal in *Saipem v. Bangladesh* summarized the relevance of previous decisions as follows:

The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.³²⁷

e) Writings

188 As would be expected, ICSID tribunals and *ad hoc* committees have also frequently relied on academic writings. With regard to the interpretation of the ICSID Convention, the First Edition of this Commentary has frequently been relied upon by ICSID tribunals.³²⁸

f) Resolutions and Guidelines

189 In addition to the classical sources of international law as enumerated in Art. 38(1) of the Statute of the ICJ, ICSID tribunals have also had occasion to refer to resolutions of the General Assembly on questions of nationalization.³²⁹

190 During the drafting of the Convention, concern that the scarcity of well-established rules in the area of international investment law might cause difficulties led the French and British representatives to propose that at least a general code of conduct or guidelines for the investor and the host country should be laid down (History, Vol. II, pp. 418, 420). At the time of drafting it did not appear possible to enter into the substance of investment law. However, the World Bank has since adopted guidelines on the treatment of foreign direct investment.³³⁰

191 When looking at such guidelines and General Assembly resolutions, it must be borne in mind that they do not necessarily reflect “rules of international law” in the sense of Art. 42(1). They may become part of the law applicable by virtue of their incorporation into an agreement on choice of law under the first sentence of Art. 42(1) (see para. 42 *supra*), through a reference contained in a treaty, or because they reflect customary international law.

³²⁷ *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, para. 67. See also *Noble Energy v. Ecuador*, Decision on Jurisdiction, 5 March 2008, para. 50.

³²⁸ For a comprehensive survey of citations see *Commission, J. P.*, Precedent in Investment Treaty Arbitration – A Citation Analysis of a Developing Jurisprudence, 24 *Journal of International Arbitration* 129–158 (2007).

³²⁹ *Amco v. Indonesia*, Award, 20 November 1984, para. 188; *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 366; *SPP v. Egypt*, Dissenting Opinion to Award, 20 May 1992, 3 ICSID Reports 254/5.

³³⁰ Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, 31 ILM 1363 (1992).

F. “. . . as may be applicable.”

1. *Applicability of International Law to Investment Disputes*

a) *Reliance of Private Parties on International Law*

The Report of the Executive Directors in defining the term “international law” refers to Art. 38(1) of the Statute of the International Court of Justice but adds that allowance would have to be made for the fact that Article 38 was designed to apply to inter-State disputes (see para. 169 *supra*). The meaning of this qualification is by no means clear. It could mean that rules of international law would have to be appropriately adjusted to apply to relationships in which one party is not a State. For instance, rules of the Vienna Convention on the Law of Treaties might be adapted to apply to agreements between investors and host States. It could also mean that rules of international law, which by their nature are designed to apply between States, are not applicable between a State and a foreign investor. The latter view has prompted some authors to argue that the remedies of a private investor would arise solely from its contractual relationship with the host State and that the private party cannot invoke the principles of State responsibility.³³¹ **192**

This view appears unfounded. Already in the course of the Convention’s drafting, it was repeatedly pointed out, especially by the Chairman (Mr. Broches), that an investor before an ICSID tribunal would have identical rights to those of its government exercising diplomatic protection (History, Vol. II, pp. 259, 267, 400, 420). *E. Lauterpacht* has argued cogently that the waiver of diplomatic protection contained in Art. 27(1) makes it essential that the Convention provides a substitute for the consideration of the international law aspect which is excluded by that provision.³³² The purpose of the Convention, advancing the cause of investment, could not be achieved by withdrawing an important procedure for the investor’s protection without having all legal issues decided by a single tribunal.³³³ In addition, enforcement of awards under Art. 54 is only conceivable if they are in conformity with international law.³³⁴ **193**

This line of reasoning was adopted by the *ad hoc* Committee in *Amco v. Indonesia* which found that the application of international law and its precedence over domestic law was **194**

. . . suggested by an overall evaluation of the system established by the Convention. The law of the host State is, in principle, the law to be applied in resolving the dispute. At the same time, applicable norms of international law must be complied with since every ICSID award has to be recognized, and pecuniary

331 *Toope, S. J.*, Mixed International Arbitration. Studies in Arbitration Between States and Private Persons 243 *et seq.* (1990); *Masood*, Law Applicable, p. 321.

332 *Lauterpacht*, The World Bank Convention, pp. 655/6. See also History, Vol. II, p. 803.

333 *Ibid.*, at p. 660.

334 *Giardina, A.*, The International Centre for Settlement of Investment Disputes between States and Nationals of Other States (ICSID), *in*: Essays on International Commercial Arbitration (*Sarcevic, P.* ed.) 214 at 217/8 (1989).

obligations imposed by such award enforced, by every Contracting State of the Convention (Art. 54(1), Convention). Moreover, the national State of the investor is precluded from exercising its normal right of diplomatic protection during the pendency of the ICSID proceedings and even after such proceedings, in respect of a Contracting State which complies with the ICSID award (Art. 27, Convention). The thrust of Article 54(1) and of Article 27 of the Convention makes sense only under the supposition that the award involved is not violative of applicable principles and rules of international law.³³⁵

195 In a number of investment cases, the question arose whether private parties could invoke the principles of State responsibility even though these principles primarily address responsibility between States. The International Law Commission clarified, however, that its 2001 Articles on State Responsibility³³⁶ “apply to the whole field of the international obligations of States, whether the obligation is owed to one or several States, to an individual or group, or to the international community as a whole”.³³⁷ ICSID tribunals thus have had no difficulty in relying on State responsibility principles, especially those concerning the attribution of conduct to host States, or the preclusion of wrongfulness.³³⁸

196 In *Azurix v. Argentina*, the Tribunal relied on customary international law principles as evidenced by the ILC Articles on State Responsibility in order to attribute acts of Argentine provinces to the Republic of Argentina. The Tribunal held:

The responsibility of States for acts of its organs and political subdivisions is well accepted under international law. The Draft Articles [. . .] are the best evidence of such acceptance and as such have been often referred to by international arbitral tribunals in investor-State arbitration.³³⁹

197 The application of international law to the relationship between a State and a foreign investor is not limited to reliance of private parties on international law. It may also result from the invocation of international law by host States. The cases in which Argentina invoked the plea of necessity as a ground for precluding international wrongfulness provide examples of such a situation. Without explicitly discussing the question whether state responsibility principles were applicable to the relationship between a State and a foreign investor, the tribunals in *CMS*

³³⁵ *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 21.

³³⁶ Draft Articles on Responsibility of States for Internationally Wrongful Acts, *in*: Report of the International Law Commission on the Work of Its Fifty-third Session, UN GAOR, 56th Sess., Supp. No. 10, 43, UN Doc. A/56/10 (2001).

³³⁷ Commentaries to the Draft Articles on Responsibility of States for Internationally Wrongful Acts, adopted by the International Law Commission at its fifty-third session (2001), Official Records of the General Assembly, Fifty-Sixth Session, Supplement No. 10 (A/56/10), 62. See also *Crawford, J.*, The International Law Commission’s Articles on State Responsibility 76 (2002).

³³⁸ *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 108; *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, para. 102; *Jan de Nul v. Egypt*, Decision on Jurisdiction, 16 June 2006, para. 89; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, para. 148; *Kardassopoulos v. Georgia*, Decision on Jurisdiction, 6 July 2007, para. 190.

³³⁹ *Azurix v. Argentina*, Award, 14 July 2006, para. 50.

v. *Argentina*,³⁴⁰ *LG&E v. Argentina*,³⁴¹ *Enron v. Argentina*³⁴² and *Sempra v. Argentina*³⁴³ implicitly gave affirmative answers by applying Art. 25 of the ILC Articles as an expression of general international law on state of necessity.

b) *International Nature of Investment Disputes*

A somewhat different argument against the application of international law was put forward by the representatives of capital-importing countries during the Convention's drafting. They insisted that a foreign investor, by making the investment, submitted to the host State's law, that the host State's sovereignty required the exclusive application of its law and that reliance on international law might actually contribute to the perpetuation of an unjust system (History, Vol. II, pp. 267, 501, 505, 513/4, 571, 801 *et seq.*, 804, 984). In turn, representatives of capital-exporting countries insisted on the necessity to retain international law as part of the applicable law (at pp. 419, 421, 801, 803). At one point, representatives of capital-importing countries suggested that international law only be used in cases of alleged discrimination (at p. 800) or in order to fill lacunae in the host State's law (at pp. 802/3). Eventually, a compromise was reached which preserved the applicability of international law but yielded to demands of developing countries that the national law to be applied in the absence of agreement on choice of law would be that of the host State³⁴⁴ (see paras. 138–140 *supra*). A vote taken under these auspices produced a majority of 24 to 6 in favour of retaining the formula which included international law (at p. 804). A suggestion to limit the application of international law to cases where the domestic legislation of the host State was silent was defeated by 19 to 7 (at p. 804).³⁴⁵

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340 *CMS v. Argentina*, Award, 12 May 2005, para. 315: "The Tribunal, like the parties themselves, considers that Article 25 of the Articles on State Responsibility adequately reflect[s] the state of customary international law on the question of necessity."

341 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 245: "[. . .] the Tribunal recognizes that satisfaction of the state of necessity standard as it exists in international law (reflected in Article 25 of the ILC's Draft Articles on State Responsibility) supports the Tribunal's conclusion."

342 *Enron v. Argentina*, Award, 22 May 2007, para. 303: "The Tribunal's understanding of Article 25 of the Articles on State Responsibility, to the effect that it reflects the state of customary international law on the matter, is not different from the view of the parties in this respect. This is not to say that the Articles are a treaty or even a part of customary law themselves; it is simply the learned and systematic expression of the development of the law on state of necessity by decisions of courts and tribunals and other sources along a long period of time."

343 *Sempra v. Argentina*, Award, 28 September 2007, para. 344: "The Tribunal shares the parties' understanding of Article 25 of the Articles on State Responsibility as reflecting the state of customary international law on the matter."

344 Broches, A., The Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Applicable Law and Default Procedure, *in*: International Arbitration Liber Amicorum for Martin Domke 12 at 16 (1967).

345 For detailed accounts of the *travaux préparatoires* on this point see *Cherian*, Investment Contracts, pp. 78 *et seq.*; *Masood*, Law Applicable, p. 313.

2. Which Rules of International Law are Applicable?

- 199** The acceptance of the applicability of international law, in principle, to disputes before ICSID tribunals does not answer the question as to the meaning of the qualifying phrase “as may be applicable”. It might be inferred from these words that only some rules of international law are applicable while others are not.
- 200** There is no good reason to believe that the applicability of rules of international law might depend on their incorporation into or adoption by the host State’s domestic law. A suggestion in the course of the drafting of Art. 42(1) to make international law applicable only if the national law of the host country so provides did not prevail (History, Vol. II, p. 802). Unlike the domestic law of another country which depends on the host State’s rules on the conflict of laws for its applicability (see paras. 161–166 *supra*), international law is independent of such domestic rules. This is clear from the wording of Art. 42(1). Whereas the “rules on the conflict of laws” are linked to “the law of the Contracting State” by the word “including”, no such linkage exists for the “rules of international law”. If the drafters had intended to make the applicability of international law dependent on the provisions of the host State’s law, they would have chosen words such as “and including such rules of international law as may be applicable”, or “and such rules of international law as may be applicable by virtue of the rules of the law of the Contracting State”.³⁴⁶ Most ICSID tribunals, when applying rules of international law, have not investigated their status under the host State’s domestic law.³⁴⁷ However, some tribunals have noted that, in situations falling under Art. 42(1), second sentence, international law is applicable also by virtue of its incorporation into domestic law (see paras. 100–103 *supra*).³⁴⁸
- 201** The most plausible explanation for the words “as may be applicable” can be found in the drafting history of Art. 42(1). The Working Paper, the Preliminary Draft and the First Draft referred the tribunal to rules of national or (and) international law “as it shall determine to be applicable” (History, Vol. I, pp. 190, 192). At that stage, the idea was to let the tribunal find the proper law by applying generally accepted principles of the conflict of laws. Eventually, the view prevailed that the national law to be applied should not be left to the determination of the tribunal but should be the law of the host State (see paras. 138–140 *supra*). Therefore, the words concerning the determination of the applicable law were severed from the part of the sentence dealing with national law and were moved to the end of the paragraph.

346 *Broches*, The Convention, pp. 391/2; *Firth*, The Law Governing Contracts, p. 274; *Lauterpacht*, The World Bank Convention, p. 660.

347 See, however, the Dissenting Opinion to the Award in *AAPL v. Sri Lanka*, 27 June 1990, 4 ICSID Reports 299, which emphasizes the applicability of international law by virtue of its incorporation into Sri Lankan law.

348 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, para. 42; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 90.

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A look at the French version of the Convention confirms the impression that, in the course of drafting, this phrase lost its original meaning (History, Vol. I, pp. 190–192). The earlier drafts corresponded to their English counterpart by directing the tribunal to apply “règles de droit international ou (et) national, qu’il considère applicables”. Since the insertion of the rule on the applicability of the host State’s law, the formula “as may be applicable” is rendered in the French version by the words “en la matière” which is probably best translated as “on the subject”. It follows that this phrase is not designed to limit the rules of international law by declaring some of them inapplicable. It simply means that the relevant rules of international law are to be applied.³⁴⁹ This interpretation is corroborated by the defeat of attempts during the Convention’s drafting to limit the applicability of international law (see para. 198 *supra*).

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This interpretation was expressly endorsed by the Tribunal in *LG&E v. Argentina*. It rejected the idea that the words “as may be applicable” would make the application of international law conditional. Instead, it shared the view that the applicability criterion meant that the relevant rules of international law were to be applied. The Tribunal held:

88. With reference to the rules of international law and, particularly, to the language “as may be applicable”, found in Article 42(1) of the ICSID Convention, the Tribunal holds the view that it should not be understood as if it were in some way conditioning application of international law. Rather, it should be understood as making reference, within international law, to the competent rules to govern the dispute at issue. This interpretation could find support in the ICSID Convention’s French version that refers to the rules of international law “*en la matière*”.³⁵⁰

3. *The Relationship of International Law to Domestic Law*

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The relationship of international law to the host State’s domestic law has turned out to be the most complex question in the application of the second sentence of Art. 42(1).³⁵¹ The Working Paper and the Preliminary Draft had provided for the application of “rules of law, whether national *or* international” (emphasis added; see History, Vol. I, pp. 190, 192). The word “or”, which had indicated two mutually exclusive alternatives, was replaced by the more neutral “and” in the First Draft (History, Vol. I, p. 192; Vol. II, p. 421). An attempt to restrict the applicability of international law to filling gaps in the host State’s law was defeated (at pp. 802–804; see para. 198 *supra*). Although some mention was made of a principle of priority for domestic law which was to be “of primary importance” and would be applied “in the first place” (at pp. 571, 800, 984), a suggestion to insert the word “first” into the text was not adopted (at p. 804). It was made clear that international law would prevail where the host State’s domestic law violated international law, for instance, through a subsequent change of its own law to the

349 *Giardina*, La legge regolatrice, pp. 692/3.

350 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 88. Footnotes omitted. The Tribunal cited the First Edition of this Commentary.

351 *Di Pietro*, Applicable Law, p. 250.

detriment of the investor (at pp. 570/1, 985). The Chairman's explanation of the vote which retained the reference to international law (at p. 804; see also para. 198 *supra*) pointed out that international law would come into play both in the case of a lacuna in domestic law and in the case of any inconsistency between the two (at p. 804). Asked whether the validity of the host State's law could be questioned before an ICSID tribunal, Mr. *Broches* answered that the validity of national laws would not be at issue but that a valid law of the host State might give rise to international responsibility (at p. 986).

205 The formula of the supplemental and corrective effect of international law used to be widely accepted. Most commentators, writing on this aspect of Art. 42(1), agreed that the function of international law was to close any gaps in domestic law as well as to remedy any violations of international law that may arise through the application of host State law.³⁵²

a) Parallel Application of International and Domestic Law

206 In the practice of ICSID tribunals, especially in earlier decisions, domestic law and international law were frequently looked at side by side without any deeper analysis of their relationship. In a number of cases, the tribunals were content simply to state in general terms that there was an identity of rules or that the host State's domestic law was in conformity with international law.

207 In *Adriano Gardella v. Côte d'Ivoire*, the dispute turned on reciprocal claims for breach of a joint venture agreement. The Tribunal said:

4.3 Both parties admit that their agreement is governed by the law of the Ivory Coast. Gardella has pleaded, it is true, that the law of the Ivory Coast ought to apply, in this case, within the framework and in the context of public international law. However, Gardella has not drawn any other conclusion from that argument than that it is necessary to have regard to the rule "pacta sunt servanda" and to the principle of good faith, principles which are equally recognized by the law of the Ivory Coast as well as by French law.³⁵³

208 In *Benvenuti & Bonfant v. Congo*, the Tribunal applied the law of the Congo and international law in accordance with the second sentence of Art. 42(1) (see para.

³⁵² *Broches*, The Convention, p. 392; *Delaume, G. R.*, Transnational Contracts, Applicable Law and Settlement of Disputes, Ch. XV, 68 *et seq.* (1990); *Feuerle*, International Arbitration and Choice of Law, pp. 118/9; *Giardina, A.*, The International Centre for Settlement of Investment Disputes between States and Nationals of Other States (ICSID), in: Essays on International Commercial Arbitration (*Sarcevic, P.* ed.) 214 at 217 (1989); *Goldman*, Le droit applicable, p. 151; *Hirsch*, The Arbitration Mechanism, pp. 134, 140/1; *Jaenicke, G.*, The Prospects for International Arbitration: Disputes between States and Private Enterprises, in: International Arbitration: Past and Prospects (*Soons, A. H. A.* ed.) 155 at 159 (1990); *Kahn*, The Law Applicable, p. 213; *Lauterpacht*, The World Bank Convention, p. 660; *Sacerdoti*, Investment Arbitration Under ICSID and UNCITRAL Rules: Prerequisites, Applicable Law, Review of Awards, p. 23. See, however, *Rubino-Sammartano, M.*, International Arbitration Law 55 (1990); *Chukwumerije*, International Law and Municipal Law, pp. 82 *et seq.*; *Elombi*, ICSID Awards, pp. 66 *et seq.*; *Igbokwe, V. C.*, Developing Countries and the Law Applicable to International Arbitration, 14 Journal of International Arbitration 99, 114 *et seq.* (1997); *Nassar*, Internationalization, pp. 202 *et seq.*

³⁵³ *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, para. 4.3.

133 *supra*) but was also authorized to rule *ex aequo et bono* in accordance with Art. 42(3) (see para. 259 *infra*). The Tribunal determined that the Government had seized the Claimant’s assets and must therefore be ordered to pay damages. On the law applicable, the Tribunal was rather terse:

4.64. This principle of compensation in case of nationalization is in accordance with the Congolese Constitution and constitutes one of the generally recognized principles of international law as well as of equity.³⁵⁴

In *Klöckner v. Cameroon*, the Tribunal after examining the law of the host State on the *exceptio non adimpleti contractus* simply added that international law reaches similar conclusions³⁵⁵ (see para. 165 *supra*). **209**

In *Amco v. Indonesia*, the first Tribunal found that in the absence of an agreement on choice of law between the parties, it had to apply Indonesian law and international law (see para. 144 *supra*). It added that both parties had left no doubt that they believed both Indonesian law and international law to be applicable by constantly referring to both legal systems in their pleadings and oral arguments.³⁵⁶ **210** The Tribunal proceeded to examine a number of legal questions from the perspectives of Indonesian law and international law, finding in each case that both systems led to identical solutions. Thus, it held that under both legal systems there is a right of the State to nationalize private property in the public interest coupled with a duty to compensate the previous owner.³⁵⁷ The modalities of the revocation of the investment authorization were held contrary to Indonesian regulations as well as to the “general and fundamental principle of due process”.³⁵⁸ On the substance of Indonesia’s liability for the withdrawal of the investment authorization, the Tribunal went into a detailed examination of Indonesian as well as international law, both of which established that the Respondent had acted illegally and was liable to pay damages.³⁵⁹ In discussing the legal basis for its calculation of the damages, the Tribunal, once again, found that there was a concordance between Indonesian and international law.³⁶⁰ The investor’s right to full and effective compensation required the repatriation of the money awarded in US Dollars also under Indonesian law.³⁶¹ Finally, in determining the date for the commencement of interest, the Tribunal decided that Indonesian and international law required that interest must run from the date of the Request for Arbitration.³⁶²

These instances of a parallel application of domestic and international law, coupled with assurances of their harmony, do not provide much useful information on the interaction of the two legal systems. It is obvious that the tribunals did not draw upon international law in its supplemental function, since there were no gaps in the domestic law that needed to be filled. It is arguable that an attempt was **211**

354 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.64.

355 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 63.

356 *Amco v. Indonesia*, Award, 20 November 1984, para. 148.

357 At para. 188.

358 At para. 201.

359 At paras. 245–250.

360 At paras. 265–268.

361 At para. 280.

362 At para. 281.

made to employ international law in its corrective function. Under this reading, the tribunals made sure that the solutions offered by domestic law did not violate international law. However, the way in which the legal arguments are presented in these cases does not support the assumption that domestic law was checked against international law for compliance. Rather, each legal position was adopted after being established separately under national and international law. Such a parallel application may seem reasonable where compliance with mandatory standards of international law is at stake. It is much less convincing where the rules of international law derive from general principles of law. If a clear rule is offered by the host State's domestic law, a comparative search for general principles is of doubtful value. It will be difficult to argue that there is a general principle of law which is at variance with the host State's law. Moreover, general principles of law do not necessarily set mandatory minimum standards which must be complied with.

212 The Decision on Annulment in *Amco v. Indonesia* contains a brief hint that the *ad hoc* Committee was aware of this aspect. It approved the way in which the Tribunal had substantiated Indonesia's obligation under Indonesian law to pay damages in US Dollars outside Indonesia and converted as of the day on which the damage occurred (see para. 210 *supra*). However, it added that the Tribunal's amplification concerning international law in this regard appeared *obiter*.³⁶³ In *Mobil Oil v. New Zealand*, the Tribunal found it unnecessary to deal with "the difficult questions of international law" since it found in favour of Mobil on the basis of New Zealand law.³⁶⁴

213 Considerations of this kind may have been on the minds of the Tribunal in *SOABI v. Senegal*. After citing Art. 42(1), the Tribunal determined that there was no agreement on choice of law between the parties and concluded that, under the prevailing circumstances, the applicable law could only be Senegalese law³⁶⁵ (see paras. 145, 146 *supra*). It proceeded to examine the legal questions surrounding the Government's unilateral termination of the contract purely from the perspective of the host State's law. On this basis, it found in favour of the investor and awarded compensation.³⁶⁶ It is possible that the Tribunal examined the results reached on the basis of domestic law for compliance with international law but found it unnecessary to say so. More probably, the lack of any reference to international law was caused by a failure of the parties to plead it before the Tribunal.

b) Supplemental and Corrective Function of International Law

214 Starting with the *ad hoc* Committee's decision in *Klöckner v. Cameroon*, a more careful discussion of the interaction of international and national law can be observed. The Tribunal had based part of its Award on a somewhat broadly defined

³⁶³ *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 118.

³⁶⁴ *Mobil Oil v. New Zealand*, Findings on Liability, Interpretation and Allied Issues, 4 May 1989, 4 ICSID Reports 196/7. See also at pp. 166 and 210.

³⁶⁵ *SOABI v. Senegal*, Award, 25 February 1988, para. 5.01.

³⁶⁶ At paras. 5.01 *et seq.*

principle which it sought to base on French law as well as on other national codes (see paras. 15, 150, 181, 209 *supra*). The *ad hoc* Committee said:

Article 42 of the Washington Convention certainly provides that “in the absence of agreement between parties, the Tribunal shall apply the law of the Contracting State party to the dispute . . . and *such principles of international law as may be applicable*”. This gives these principles (perhaps omitting cases in which it should be ascertained whether the domestic law conforms to international law) a dual role, that is, *complementary* (in the case of a “lacuna” in the law of the State), or *corrective*, should the State’s law not conform on all points to the principles of international law. *In both cases*, the arbitrators may have recourse to the “principles of international law” only *after* having inquired into and established the content of the law of the State party to the dispute (which cannot be reduced to *one* principle, even a basic one) and *after* having applied the relevant rules of the State’s law.

Article 42(1) therefore clearly does not allow the arbitrator to base his decision *solely* on the “rules” or “principles of international law”.³⁶⁷

The decision thus confirms the supplemental and corrective functions of international law while emphasizing that an award may not be based on international law alone.

The Award in *LETCO v. Liberia* determined that the parties had by their reference to Liberian legislation in the Concession Agreement chosen the law of Liberia as the governing law (see para. 64 *supra*). In response to the Claimant’s argument that no express choice of law had been made and that, therefore, the second sentence of Art. 42(1) applied, the Tribunal said:

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This provision of the ICSID Convention envisages that, in the absence of any express choice of law by the parties, the Tribunal must apply a system of concurrent law. The law of the Contracting State is recognized as paramount within its own territory, but is nevertheless subjected to control by international law. The role of international law as a “regulator” of national systems of law has been much discussed, with particular emphasis being focused on the problems likely to arise if there is divergence on a particular point between national and international law. No such problem arises in the present case; the Tribunal is satisfied that the rules and principles of Liberian law which it has taken into account are in conformity with generally accepted principles of public international law governing the validity of contracts and the remedies for their breach.³⁶⁸

In view of the prior finding that there had been an agreed choice of law, the Tribunal’s observations on the interpretation of the second sentence of Art. 42(1) are *obiter*. It is still worth noting that the Tribunal examined the merits of the case on the basis of national as well as international law (see para. 106 *supra*).

367 *Klökner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 69. Italics original. The original decision was rendered in French. The reference to “principles of international law” rather than “rules of international law” is explained by a discrepancy between the French and English texts of Art. 42(1). See paras. 167, 168 *supra*.

368 *LETCO v. Liberia*, Award, 31 March 1986, 2 ICSID Reports 358/9.

216 The *ad hoc* Committee in *Amco v. Indonesia* approved of the Tribunal's use of Art. 42³⁶⁹ (see para. 210 *supra*). It reiterated the formula of the supplemental and corrective function of international law:

20. It seems to the *ad hoc* Committee worth noting that 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.³⁷⁰

It found that this relationship of international law vis-à-vis the law of the host State was suggested by an overall evaluation of the Convention's system, notably by Arts. 27 and 54(1)³⁷¹ (see para. 194 *supra*).

217 The second Tribunal in the resubmitted case of *Amco v. Indonesia* noted the positions of the first Tribunal and of the *ad hoc* Committee (see paras. 210, 216 *supra*). It also observed that Indonesia had advanced legal arguments on each of the issues under, first, the heading of Indonesian law and, second, the heading of international law. Nevertheless, counsel for Indonesia had explained that international law was only relevant if there was a lacuna in the law of the host State, or if the law of the host State was incompatible with international law, in which case the latter would prevail. Amco submitted no contrary arguments. The Tribunal said:

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. In any event, the Tribunal believes that its task is to test every claim of law in this case first against Indonesian law, and then against international law.³⁷²

218 The Tribunal proceeded to examine the substantive questions before it in accordance with this method. On the point of the revocation of Amco's licence the Tribunal first looked into Indonesian law concluding that it did not clearly stipulate whether a procedurally unlawful act *per se* generates compensation or whether a decision tainted by bad faith is necessarily unlawful.³⁷³ It then turned to international law finding that there the decisive criterion was the existence of a denial of justice. It concluded that the circumstances surrounding the revocation of the licence constituted a denial of justice making the decision unlawful irrespective of certain substantive grounds that may have existed for it.³⁷⁴ The procedure employed by the Tribunal to establish principles of compensation and the method of valuation was similar. It found that non-speculative lost profits were recoverable

369 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 19.

370 At para. 20.

371 *Loc. cit.*

372 *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, para. 40.

373 At para. 121.

374 At paras. 136–139.

under both legal systems.³⁷⁵ As to valuation, it found the discounted cash flow method appropriate. This method was supported by international authority but neither prescribed nor prohibited in Indonesian law. It concluded:

The Tribunal finds it a method that is entirely consistent with Indonesian law and international law.³⁷⁶

In *SPP v. Egypt*, the Tribunal refused to decide whether an agreed choice of law had taken place, finding that, either way, Egyptian and international law would have to be applied (see paras. 65–67 *supra*). It found that if municipal law contained a lacuna or if international law was violated by the exclusive application of municipal law, the Tribunal was bound to apply international law directly. It proceeded to apply international law in addition to national law in a variety of contexts (see paras. 107, 108 *supra*). The Tribunal’s findings on interest offer some interesting insights concerning the interaction of national and international law. On the rate of interest it held that the determination must be made according to Egyptian law because there was no rule of international law that would fix the rate or proscribe the limitation imposed by Egyptian law.³⁷⁷ On the other hand, the Tribunal observed that Egyptian law lacked any provision concerning the date from which interest would run for compensation arising out of an act of expropriation. In the face of this gap in the host State’s law, the Tribunal turned to international law, which it found to offer a rule providing for interest from the date on which the dispossession effectively took place.³⁷⁸

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AGIP v. Congo was not decided under the second sentence of Art. 42(1), but the choice of law clause agreed to by the parties resembles the residual rule of Art. 42(1) in that it provided for the application of the law of the host State “supplemented if need be by any principles of international law” (see para. 33 *supra*). The Tribunal came to the conclusion that the Congolese ordinance which had nationalized the Claimant’s property was illegal even under Congolese law. However, it left no doubt that the claim would have been upheld under international law, even if no illegality under Congolese law had been found to exist.³⁷⁹ The “supplementation” of the host State’s law by international law clearly led to its correction (see paras. 97, 98, 120 *supra*).

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In *Tradex v. Albania*, the Tribunal found that it had jurisdiction on the basis of the Albanian Law on Foreign Investment of 1993 (see Art. 25, para. 395). The Tribunal held that the 1993 Law was determinative also of the merits of the case to the exclusion of other sources including international law.³⁸⁰ But the Tribunal added that in applying the second sentence of Art. 42(1) it would use and take guidance from sources of international law for the interpretation of the term “expropriation” used in the 1993 Law³⁸¹ (see also Art. 25, para. 525).

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375 At paras. 171–178.

376 At para. 197.

377 *SPP v. Egypt*, Award, 20 May 1992, para. 222. See also *Delaume*, L’affaire, p. 57.

378 At paras. 232–234. See also *Delaume*, L’affaire, p. 60.

379 *AGIP v. Congo*, Award, 30 November 1979, paras. 79–88.

380 *Tradex v. Albania*, Award, 29 April 1999, paras. 68–69.

381 At paras. 69, 135–136.

222 In *Santa Elena v. Costa Rica*, the Tribunal found that the parties had not reached a clear and unequivocal agreement that their dispute would be decided solely in accordance with international law (see para. 22 *supra*). Therefore, it had to rely on the second sentence of Art. 42(1). After stating that the relevant rules and principles of Costa Rican law were generally consistent with international law, it added that in case of any inconsistency public international law would have to prevail. This led the Tribunal to the conclusion that international law was controlling.³⁸² Somewhat surprisingly, it held that:

The Tribunal is satisfied that, under the second sentence of Art. 42(1), the arbitration is governed by international law.³⁸³

It proceeded by applying the appropriate rules of international law.

223 The Award in *Wena Hotels v. Egypt* provides another example of the “corrective” function of international law. The Tribunal first determined that pursuant to Art. 42(1) it had to apply both Egyptian law and international law. The host State had argued that one of the investor’s claims was time-barred on the basis of Egyptian legislation. The Tribunal refused to apply the domestic law statute of limitations because it considered it to be contrary to international law. The Tribunal held that:

strict application of [the] three-year limit, even if applicable, would collide with the general, well-established international principle recognized since before the *Gentini* case: that municipal statutes of limitation do not bind claims before an international tribunal [. . .]³⁸⁴

224 The Tribunal in *Autopista v. Venezuela* again stressed the “corrective and supplemental functions of international law”. In finding that there was no choice of law by the parties, the Tribunal held that it had to rely upon Art. 42(1), second sentence, ICSID Convention, and held:

102. The role of international law in ICSID practice is not entirely clear. It is certainly well settled that international law may fill lacunae when national law lacks rules on certain issues (so called complementary function). It is also established that it may correct the result of the application of national law when the latter violates international law (corrective function). [. . .] Whatever the extent of the role that international law plays under Article 42(1) (second sentence), this Tribunal believes that there is no reason in this case, considering especially that it is a contract and not a treaty arbitration, to go beyond the corrective and supplemental functions of international law.³⁸⁵

225 On this basis, the Tribunal held that the dispute must be resolved by Venezuelan law. However, it added that “international law prevails over conflicting national rules”.³⁸⁶

³⁸² *Santa Elena v. Costa Rica*, Award, 17 February 2000, paras. 28, 35, 37, 40, 60–68.

³⁸³ At para. 65.

³⁸⁴ *Wena Hotels v. Egypt*, Award, 8 December 2000, para. 107. To the same effect: *Maffezini v. Spain*, Award, 13 November 2000, paras. 92, 93.

³⁸⁵ *Autopista v. Venezuela*, Award, 23 September 2003, para. 102. The Tribunal cited the First Edition of this Commentary.

³⁸⁶ At para. 105. See also para. 207.

In *LG&E v. Argentina*, the Tribunal found that submission to the BIT was not sufficient to indicate an implicit agreement on choice of law (see para. 95 *supra*). The Tribunal was explicit about the superiority of international law under the second sentence of Article 42(1): **226**

International law overrides domestic law when there is a contradiction since a State cannot justify non-compliance of its international obligations by asserting the provisions of its domestic law.³⁸⁷

A similar outcome was reached in *MCI v. Ecuador*. After finding that the parties had not even implicitly agreed on the applicable law the Tribunal resorted to Art. 42(1), second sentence, and concluded: **227**

In the event of possible contradictions between the rules of Ecuadorian law and the BIT and other applicable rules of general international law, the Tribunal will decide on their compatibility, bearing in mind the contents and purpose of those rules in light of the precedence that international rules take over the domestic legislation of a State.³⁸⁸

The Tribunal in *Goetz v. Burundi* summarized the practice of tribunals, and the discussion surrounding it, in the following terms: **228**

97. In the previous case-law the problem of the links between the various applicable sources of international law is posed in the context of the second sentence of Article 42, first paragraph, of the ICSID Convention, and it has received divergent responses, abundantly commented on in academic writings: hierarchal relationships according to some, domestic law applying first of all but being overborne where it contradicts international law; according to others, relationships based on subsidiarity, with international law being called upon only to fill lacunae or to settle uncertainties in national law; according to others again, complementary relationships, with domestic law and international law each having its own sphere of application.³⁸⁹

The *ad hoc* Committee in *Wena Hotels v. Egypt* gave a broad overview of the past practice of ICSID tribunals in the following terms: **229**

38. This discussion brings into light the various views expressed as to the role of international law in the context of Article 42(1). Scholarly opinion, authoritative writings and some ICSID decisions have dealt with this matter. Some views have argued for a broad role of international law, including not only the rules embodied in treaties but also the rather large definition of sources contained in Article 38(1) of the Statute of the International Court of Justice. Other views have expressed that international law is called in to supplement the applicable domestic law in case of the existence of *lacunae*. In *Klöckner I* the *ad hoc* Committee introduced the concept of international law as *complementary* to the applicable law in case of *lacunae* and as *corrective* in case that the applicable domestic law would not conform on all points to the principles of international law. There is also the view that international law has a controlling function of domestic applicable law to

387 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 94.

388 *MCI v. Ecuador*, Award, 31 July 2007, para. 218.

389 *Goetz v. Burundi*, Award, 10 February 1999, para. 97.

the extent that there is a collision between such law and fundamental norms of international law embodied in the concept of *jus cogens*.

39. Some of these views have in common the fact that they are aimed at restricting the role of international law and highlighting that of the law of the host State. Conversely, the view that calls for a broad application of international law aims at restricting the role of the law of the host State. There seems not to be a single answer as to which of these approaches is the correct one. The circumstances of each case may justify one or another solution. [. . .]³⁹⁰

230 The main points emerging from the practice, as outlined above, may be summarized as follows:³⁹¹

1. A tribunal applying the second sentence of Art. 42(1) may not restrict itself to applying either the host State's law or international law but must examine the legal questions at issue under both systems.

2. A decision which can be based on the host State's domestic law need not be sustained by reference to general principles of law.

3. A tribunal may give a decision based on the host State's domestic law, even if it finds no positive support in international law as long as it is not prohibited by any rule of international law.

4. A tribunal may not render a decision on the basis of the host State's domestic law which is in violation of a mandatory rule of international law.

5. A claim which cannot be sustained on the basis of the host State's domestic law must be upheld if it has an independent basis in international law.

231 The complex relationship between national and international law under Art. 42(1), second sentence, has given rise to a range of different interpretations amongst legal scholars. While most writers seem to adhere to the "supplemental and corrective function" approach, some have called for an entirely autonomous application of international law.

232 Even those scholars who follow the dominant view of a "supplemental and corrective function of international law" come to markedly divergent results, depending on whether they emphasize the importance of domestic or of international law.

233 *W. M. Reisman* would limit the relevance of international law by asserting that the corrective function would only apply in the case of "international *jus cogens*".³⁹² Specifically referring to Article 53 of the Vienna Convention on the Law of Treaties, *Reisman* proposes that "the test, then, is not inconsistency, but whether applying the Contracting State's law would constitute a violation of something fundamental to international law".³⁹³

390 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, paras. 38–39. Footnotes omitted; emphasis original.

391 See also *Gaillard, E.*, Centre International pour le Règlement des Différends relatifs aux Investissements (CIRDI), 118 *Journal du Droit International* 165 at 182/3 (1991).

392 *Reisman*, The Regime for *Lacunae* in the ICSID Choice of Law Provision, pp. 374 *et seq.*

393 At p. 375.

In contrast, *P. Weil* has stressed the importance of international law.³⁹⁴ He rejects the “complex and multifaceted” theories about the relationship between domestic and international law under Art. 42(1), second sentence, as “futile”, arguing that “under the second sentence of Article 42(1), international law always gains the upper hand and ultimately prevails”.³⁹⁵ According to his theory, international law would either prevail “indirectly” through the application of domestic law where the latter is deemed consistent with international law or incorporates it, or “directly” where domestic law is deemed deficient or contrary to international law.³⁹⁶ From this point of view, the reference to the domestic law of the host State “is indeed a pointless exercise, the sole *raison d’être* of which is to avoid offending the sensibilities of the host State”.³⁹⁷ 234

Weil’s theory is based mainly upon the pronouncements of the second Tribunal in the resubmitted case of *Amco v. Indonesia* which had noted that “international law is fully applicable and to classify its role as ‘only’ ‘supplemental and corrective’ seems a distinction without a difference”.³⁹⁸ 235

c) Autonomous Application of Both Legal Systems

The *ad hoc* Committee in *Wena Hotels v. Egypt*, after giving a broad overview of practice (see para. 223 *supra*), made the following statement on the relationship of host State law and international law: 236

[. . .] the use of the word “may” in the second sentence of this provision [Art. 42(1)] indicates that the Convention does not draw a sharp line for the distinction of the respective scope of international and of domestic law and, correspondingly, that this has the effect to confer on to the Tribunal a certain margin and power for interpretation.

40. What is clear is that the sense and meaning of the negotiations leading to the second sentence of Article 42(1) allowed for both legal orders to have a role. The law of the host State can indeed be applied in conjunction with international law if this is justified. So too international law can be applied by itself if the appropriate rule is found in this other ambit.³⁹⁹

The broad statement that “international law can be applied by itself if the appropriate rule is found in this other ambit”⁴⁰⁰ has given rise to an alternative interpretation of the role of international law. The theory of the supplemental and corrective functions of international law has been criticized as a misinterpretation of the clear and unambiguous wording of Art. 42(1), second sentence, triggered by the *Klöckner* and *Amco ad hoc* Committees. According to *E. Gaillard* and *Y. Banifatemi*, neither the wording nor the drafting history of the ICSID Convention 237

394 *Weil*, *The State, the Foreign Investor and International Law*, pp. 401 *et seq.*

395 At p. 409.

396 *Loc. cit.*

397 *Loc. cit.*

398 *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, para. 40.

399 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002, paras. 39, 40.

400 This passage was quoted with approval in *Siemens v. Argentina*, Award, 6 February 2007, para. 77.

supports the view that international law would come into play only in cases of lacunae or inconsistency.⁴⁰¹ Instead, they argue that ICSID tribunals “may also apply international law as a body of substantive rules in order to resolve the dispute or a particular issue”.⁴⁰² Based on the decision of the *ad hoc* Committee in *Wena Hotels v. Egypt*, they argue that “each ICSID tribunal should have discretion to decide whether any rules of international law are directly applicable, without any requirement of initial scrutiny into the law of the host State”.⁴⁰³ In their view, this approach “is consistent with both the text of Article 42(1) – ‘and’ should only mean ‘and’ – and its object and purpose”.⁴⁰⁴

238 This view was expressly endorsed by the Tribunal in *LG&E v. Argentina* which held:

96. It is this Tribunal’s opinion that “and” means “and”, so that the rules of international law, especially those included in the ICSID Convention and in the Bilateral Treaty, as well as those of domestic law are to be applied. In the *Wena Hotels Limited v. Arab Republic of Egypt* case, the Tribunal affirmed that “and means and”, but accepted the supremacy of international law.⁴⁰⁵

239 ICSID tribunals are increasingly turning to a simultaneous application of international law and domestic law. In cases falling under the residual rule of Art. 42(1), second sentence, they will apply domestic law to some aspects of disputes and rules of international law to other aspects.

240 Tribunals, like the one in *CMS v. Argentina*, have called for a “more pragmatic and less doctrinaire approach”.⁴⁰⁶ The dispute arose from the unilateral suspension and later abrogation of various tariff stipulations under a long-term licence for the transport of gas. Since there was no express choice of law and since the BIT did not contain a provision on applicable law, the Tribunal had to revert to Art. 42(1), second sentence.⁴⁰⁷ It noted that both parties had invoked both national and international law rules.⁴⁰⁸ It concluded that it would apply the Argentine constitution, Civil Code, gas legislation and regulations, as well as Argentina’s emergency law, while it would “also apply” the BIT and customary international law “in reaching the pertinent conclusions”.⁴⁰⁹

241 In justifying this “à la carte” approach, the *CMS* Tribunal expressly relied upon the decision of the *ad hoc* Committee in *Wena Hotels v. Egypt*.⁴¹⁰ The Tribunal held:

116. More recently, however, a more pragmatic and less doctrinaire approach has emerged, allowing for the application of both domestic law and international law if the specific facts of the dispute so justifies. It is no longer the case of one prevailing over the other and excluding it altogether. Rather, both sources have a role to play. [. . .]

401 *Gaillard/Banifatemi*, The Meaning of “and”, pp. 382 *et seq.*

402 At p. 399.

403 At p. 409.

404 *Loc. cit.*

405 *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para. 96.

406 *CMS v. Argentina*, Award, 12 May 2005, para. 116.

407 At para. 108.

408 At para. 118.

409 At para. 122.

410 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002.

117. This is the approach this Tribunal considers justified when taking the facts of the case and the arguments of the parties into account. Indeed, there is here a close interaction between the legislation and the regulations governing the gas privatization, the License and international law, as embodied both in the Treaty and in customary international law. All of these rules are inseparable and will, to the extent justified, be applied by the Tribunal.⁴¹¹

Other ICSID tribunals have also followed a more pragmatic, fact-specific approach in determining the applicable law and, in particular, the relationship between international and domestic law.⁴¹² Again, relying upon the *ad hoc* Committee's decision in *Wena v. Egypt*,⁴¹³ the Tribunal in *Azurix v. Argentina* said: **242**

66. Article 42(1) has been the subject of controversy on the respective roles of municipal law and international law. It is clear from the second sentence of Article 42(1) that both legal orders have a role to play, which role will depend on the nature of the dispute and may vary depending on which element of the dispute is considered. The Annulment Committee in *Wena v. Egypt* considered that "The law of the host State can indeed be applied in conjunction with international law if this is justified. So too international law can be applied by itself if the appropriate rule is found in this other ambit."

67. *Azurix's* claim has been advanced under the BIT and, as stated by the Annulment Committee in *Vivendi II*, the Tribunal's inquiry is governed by the ICSID Convention, by the BIT and by applicable international law. While the Tribunal's inquiry will be guided by this statement, this does not mean that the law of Argentina should be disregarded. On the contrary, the law of Argentina should be helpful in the carrying out of the Tribunal's inquiry into the alleged breaches of the Concession Agreement to which Argentina's law applies, but it is only an element of the inquiry because of the treaty nature of the claims under consideration.⁴¹⁴

The Tribunal in *Sempra v. Argentina* also opted for a solution that gives both legal systems an autonomous and simultaneous role. In response to a detailed discussion of the parties concerning the meaning of Art. 42(1) the Tribunal said: **243**

235. The parties' discussion concerning Article 42(1) of the Convention appears to be theoretical to some extent since this Article provides for a variety of sources to play simultaneous roles. Indeed, the Respondent is right to argue that domestic law is not confined in scope of application to the determination of factual questions. It indeed has a broader role, as is evident from the pleadings and arguments of the parties to this very case. The License is itself governed by the legal order of the Argentine Republic, and it must be interpreted in its light.

411 *CMS v. Argentina*, Award, 12 May 2005, paras. 116–117.

412 See also *MTD v. Chile*, Award, 25 May 2004, para. 204; *Enron v. Argentina*, Award, 22 May 2007, paras. 205–209. But see *Tokios Tokelès v. Ukraine*, Award, 26 July 2007, para. 143, where the Tribunal, after endorsing the approach of the *Wena ad hoc* Committee, found that the system of protection provided by Ukrainian law was "replaced *ratione materiae* by the substantive provisions of the Treaty and international law, to the extent that the latter govern the same subject-matter".

413 *Wena Hotels v. Egypt*, Decision on Annulment, 5 February 2002.

414 *Azurix v. Argentina*, Award, 14 July 2006, paras. 66–67. Footnotes omitted.

236. So too, the Claimant is right in arguing for the prominent role of international law. In fact, the Treaty, international conventions and customary law have been invoked by the parties in respect of a number of matters. While writers and decisions have on occasion tended to consider domestic law and international law as mutually incompatible in their application, this is far from actually being the case. Both have a role to perform in the resolution of the dispute, as has been recognized.⁴¹⁵

The Tribunal proceeded to examine the issues before it, first under the law of Argentina, and then under international law.⁴¹⁶

244 This pragmatic, fact-specific approach means that tribunals will have to identify the various legal issues before them in their proper legal contexts. Tribunals will then apply international law to some of these issues and domestic law to other issues. Tribunals will not have complete discretion in selecting international and domestic law. They will have to identify the questions to which the respective legal systems apply.

G. “(2) The Tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.”

245 This provision directs that the tribunal may not refuse to give a decision on the ground that the law is not sufficiently clear. It applies equally to a refusal to render an award at all and to a refusal to decide certain questions only. Art. 42(2) is reinforced by Art. 48(3) which says that the award shall deal with every question submitted to the tribunal. The prohibition of *non liquet* is generally accepted in international adjudication.⁴¹⁷ It was adopted from Art. 11 of the International Law Commission’s Model Rules on Arbitral Procedure.⁴¹⁸ The wording remained essentially unchanged throughout the Convention’s drafting (History, Vol. I, p. 194) and evoked virtually no comment (History, Vol. II, pp. 158, 330, 805).

246 Art. 42(2) applies irrespective of the choice of law under Art. 42(1). It must be observed whether the parties have agreed on applicable rules of law or whether the residual rule referring the tribunal to the host State’s domestic law and to international law is applied. The underlying assumption is that the body of law provided by Art. 42(1) is sufficiently complete to provide an answer to every question which may come before the tribunal. In the case of an agreed choice of law, the tribunal must first exhaust the possibilities for closing any perceived gaps within the chosen rules of law. Where a domestic system of law has been chosen, the appropriate rules of that system for closing lacunae have to be utilized.⁴¹⁹

415 *Sempra v. Argentina*, Award, 28 September 2007, paras. 235, 236. Footnotes omitted.

416 At paras. 241 *et seq.*, 270 *et seq.*

417 Stone, J., *Non-liquet* and the Function of Law in the International Community, 35 BYIL 124 (1959); Lauterpacht, H., Some Observations on the Prohibition of “Non Liquet” and the Completeness of the Law, *in*: *Symbolae Verzijl* 196 (1958).

418 YBILC 84 (1958-II).

419 *Shihata/Parra*, *Applicable Substantive Law*, pp. 195/6.

If the chosen law provides no answer, the tribunal will have recourse to the residual rule in Art. 42(1), second sentence (see paras. 135–137 *supra*). The combination of the host State’s law and international law offers such a broad range of authority that a genuine *non liquet* is almost unthinkable.⁴²⁰ Gaps in the host State’s law may be filled through international law’s supplemental function.⁴²¹ In this process, a tribunal will deal with a silence of the law on a specific point through such techniques as analogy, looking at the general legal context and applying broader principles.⁴²² Obscurities of the law will be clarified by various interpretation techniques including object and purpose. Non-binding authority such as judicial decisions, scholarly writings, resolutions or codes of conduct may assist the tribunal (see paras. 183–191 *supra*). General principles of law will frequently provide guidance where other sources fail. 247

Nevertheless, it must be borne in mind that applicable rules must be proven and cannot simply be assumed or postulated (see para. 182 *supra*). The function of closing gaps is inherently different from that of applying equity under Art. 42(3). Decisions *ex aequo et bono* require the specific consent of the parties (see paras. 260–265 *infra*). The tribunal’s obligation under Art. 48(3) to state the reasons for the award requires rigorous legal reasoning. Failure to do so will expose the award to annulment under Art. 52(1)(e). Failure to apply positive law may constitute an excess of powers under Art. 52(1)(b) (see paras. 14–20 *supra*). 248

H. “(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.”

1. General Meaning

Art. 42(3) provides that a tribunal, if it is so authorized by the parties, may base its award on extra-legal considerations which it regards as equitable.⁴²³ In other words, it may disregard the rules of law otherwise applicable under Art. 42(1) in favour of justice and fairness. In a sense, this provision is an extension of Art. 42(1), first sentence. The parties are free not only to choose the rules of law to be applied but may also go beyond these rules and choose equity. But it must be borne in mind that while an authorization under Art. 42(3) achieves maximum flexibility it does so at considerable cost to predictability. 249

Decisions *ex aequo et bono* do not have the function of filling gaps in the applicable law thereby assisting tribunals to avoid a *non liquet* in accordance with Art. 42(2). Decisions based on law must be distinguished from decisions based on equity. Where parties have not agreed to authorize the tribunal to decide *ex aequo* 250

⁴²⁰ *Di Pietro*, Applicable Law, p. 259.

⁴²¹ *Cherian*, Investment Contracts, pp. 77, 84 *et seq.*

⁴²² *Masood*, Law Applicable, p. 323.

⁴²³ More generally see *Schreuer, C.*, Decisions Ex Aequo et Bono Under the ICSID Convention, 11 ICSID Review – FILJ 37 (1996).

et bono, it must remain within the limits of the applicable rules of law (see paras. 260–265 *infra*).

- 251** Art. 42(3) does not adopt a distinction between legal and non-legal disputes. Under Art. 25(1), the jurisdiction of the Centre extends to legal disputes only. Therefore, questions decided *ex aequo et bono* are capable of being decided in accordance with rules of law. It is not the nature of the dispute but the parties' agreement that makes equity applicable to it.
- 252** An agreement to authorize the tribunal to decide *ex aequo et bono* may be particularly appropriate in the case of complex long-term relationships. As an investment evolves over time, new circumstances may appear which were not taken into account originally. If a re-negotiation turns out to be impossible, the tribunal's power to decide *ex aequo et bono* may be a second-best method to achieve a result which is fair and suitable to changed circumstances.⁴²⁴
- 253** The possibility to authorize a tribunal to decide *ex aequo et bono* was envisaged throughout the Convention's drafting history and has elicited very little comment (History, Vol. I, pp. 194–196; see also paras. 260, 266 *infra*). The text, as eventually adopted, closely follows Art. 38(2) of the Statute of the International Court of Justice. Other documents governing international arbitration contain similar clauses.⁴²⁵

2. Agreement on Decision *ex aequo et bono*

a) Drafting the Agreement

- 254** The power of the tribunal to decide *ex aequo et bono* is contingent on an agreement by the parties. Such an agreement must be explicit. The ICSID Model Clauses of 1993 offer the following formula for use by the parties:

Clause 11

Any Arbitral Tribunal constituted pursuant to this agreement shall have the power to decide a dispute *ex aequo et bono*.⁴²⁶

- 255** The parties may also call upon the tribunal to act as an *amiabile compositeur*, although following the wording of Art. 42(3) may be preferable. In *Atlantic Triton v. Guinea*, the agreement between the parties contained the following formula:

424 Broches, The Convention, pp. 394/5; Amerasinghe, C. F., Submissions to the Jurisdiction of the International Centre for Settlement of Investment Disputes, 5 Journal of Maritime Law and Commerce 211, 240 (1973/74).

425 ICC Rules of Arbitration (1998), Art. 17(3), 36 ILM 1612 (1997); UNCITRAL Arbitration Rules (1976), Art. 33(2), 15 ILM 714 (1976); ILC Model Rules on Arbitral Procedure (1958), Art. 10(2), YBILC 84 (1958-II). See also Sohn, L. B., The Function of International Arbitration Today, 108 Recueil des Cours 1 at 41–59 (1963-I); Scheuner, U., Decisions *ex aequo et bono* by International Courts and Arbitral Tribunals, in: International Arbitration Liber Amicorum for Martin Domke 275 (1967); Lauterpacht, E., Aspects of the Administration of International Justice 117 *et seq.* (1991).

426 4 ICSID Reports 364. Cf. also Clause XVIII of the Model Clauses of 1981, 1 ICSID Reports 206 and Clause XXII of the Model Clauses of 1968, 7 ILM 1177 (1968).

... the disagreement shall be settled *ex aequo et bono* in accordance with the provisions of Article 42(3) . . .⁴²⁷

Clauses authorizing the tribunal to decide *ex aequo et bono* need not be comprehensive but may cover a limited number of points only. Other matters will then remain to be decided in accordance with rules of law.⁴²⁸ This method of *dépeçage* (see paras. 39, 40 *supra*) adds flexibility to the drafting and may facilitate compromise. In such a situation, it is perfectly reasonable to combine an agreement authorizing decision *ex aequo et bono* with an agreement on choice of law.⁴²⁹ **256**

b) *Supervening Agreement*

While an agreement on decision *ex aequo et bono* will normally be made in advance of the proceedings before the tribunal, this need not be the case. Especially where jurisdiction is not based on a direct agreement between the parties but on a treaty or on national legislation (see Art. 25, paras. 392–463), there will not be an early opportunity to agree on this question. Just as with an agreement on applicable law under Art. 42(1) (see paras. 56–61 *supra*), the parties may agree on decision *ex aequo et bono* at the beginning or in the course of the proceedings. **257**

In *AGIP v. Congo*, the Government proposed in its Counter-Memorial that the Tribunal should adopt the role of a friendly arbitrator (*amiable compositeur*). Since AGIP did not agree to this proposal, the Tribunal found that it had to make its decision in accordance with the provisions of the applicable law.⁴³⁰ **258**

In *Benvenuti & Bonfant v. Congo*, there was no agreed choice of law and the residual rule of Art. 42(1) applied (see para. 133 *supra*). At the Tribunal's first session, the Claimant suggested that the Tribunal be granted the power to decide *ex aequo et bono*. However, this initial suggestion was rejected by the Respondent.⁴³¹ **259** Later on, during the proceedings, the parties reached an agreement to attempt an amicable settlement failing which they authorized the Tribunal "to render its award as quickly as possible by judgment *ex aequo et bono*".⁴³² After being notified of the failure to settle through negotiations,⁴³³ the Tribunal proceeded to apply Art. 42(3).⁴³⁴

c) *Necessity of an Agreement*

In the course of the Convention's drafting, there was some suggestion to allow the tribunal to decide *ex aequo et bono* even without the parties' specific authorization (History, Vol. II, pp. 330, 570). On the other hand, it was pointed out that **260**

427 *Atlantic Triton v. Guinea*, Award, 21 April 1986, para. 7. For another example see *Nurick, L./Schnably, S. J.*, The First ICSID Conciliation: *Tesoro Petroleum Corporation v. Trinidad and Tobago*, 1 ICSID Review – FILJ 340, 344 (1986).

428 *Broches*, The Convention, p. 395; *Broches*, Convention, Explanatory Notes and Survey, p. 666.

429 *Amerasinghe*, Submissions to the Jurisdiction, p. 250.

430 *AGIP v. Congo*, Award, 30 November 1979, para. 44.

431 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, paras. 1.5–1.6.

432 At para. 1.22.

433 At para. 1.23.

434 At para. 4.4.

certain legal systems draw a clear distinction between arbitration under law and the reference of a dispute to *amiables compositeurs*, who had the power to decide *ex aequo et bono* (at p. 419). The Convention's text clearly follows this distinction.

261 Therefore, there can be no doubt that an explicit agreement under the terms of Art. 42(3) is an indispensable requirement for a decision *ex aequo et bono*. The application of equitable principles without the parties' authorization exposes the award to annulment for excess of powers.⁴³⁵ In *Amco v. Indonesia*, the first Tribunal noted that the parties had not agreed to entrust the Tribunal with the power to decide *ex aequo et bono* and that, therefore, it had to decide according to the applicable rules of law.⁴³⁶ Before the *ad hoc* Committee, Amco argued that this explicit recognition by the Tribunal created an overwhelming presumption that the arbitrators did indeed refrain from deciding *ex aequo et bono*. The *ad hoc* Committee rejected this argument and held that it had to "examine closely both what the Tribunal said it was doing and what it was in fact doing, in resolving particular questions".⁴³⁷ While no impermissible resort to equitable principles appeared in the Award, the *ad hoc* Committee pointed out that in view of the law applicable to the case (see para. 144 *supra*), a decision *ex aequo et bono*

... would constitute a decision annulable for manifest excess of powers. Nullity would be a proper result only where the Tribunal decided an issue *ex aequo et bono* in lieu of applying the applicable law.⁴³⁸

262 In *Klöckner v. Cameroon*, there was also no agreement on decision *ex aequo et bono*. The *ad hoc* Committee pointed out that an excess of powers might consist not only in failure to apply the governing law but also in a solution in equity where there was a requirement to decide in law.⁴³⁹ In dealing with the Tribunal's suggestion that there was a basic and general principle of full disclosure to a partner in a contractual relationship,⁴⁴⁰ the *ad hoc* Committee found that the Tribunal had failed to establish such a principle under the host State's law or under international law (see paras. 15, 150, 181 *supra*). It drew the following conclusion:

77. Now, the Award's reasoning and the legal grounds on this topic (to the extent that they are not in any case mistaken because of the inadequate description of the duty of "full disclosure") seem very much like a simple reference to equity, to "universal" principles of justice and loyalty, such as amiable compositeurs might invoke.⁴⁴¹

It followed that the Tribunal did

435 *Broches*, Convention, Explanatory Notes and Survey, p. 666; *Delaume*, L'affaire, p. 55; *Giardina, A.*, ICSID: A Self-Contained, Non-National Review System, in: *International Arbitration in the 21st Century: Towards "Judicialization" and Uniformity?* (*Lillich, R. B./Brower, C. N.* eds.) 199 at 212 (1994); *Schreuer*, Decisions Ex Aequo et Bono, pp. 53 *et seq.*

436 *Amco v. Indonesia*, Award, 20 November 1984, para. 147.

437 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, para. 24.

438 At para. 28.

439 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 59.

440 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 59.

441 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 77.

... act outside the framework provided by Article 42(1), applying concepts or principles it probably considered equitable (acting as an amiable compositeur, which should not be confused with applying “equitable considerations” as the International Court of Justice did in the *Continental Shelf* case). However justified its award may be (a question on which the Committee has no opinion), the Tribunal thus “manifestly exceeded its powers” within the meaning of Article 52(1)(b) of the Washington Convention.⁴⁴²

Similarly, the *ad hoc* Committee took issue with the Tribunal’s attempt to make a quantitative comparison of the parties’ respective failure of performance which had led it to conclude that the partial amount already paid to the Claimant corresponded equitably to the value of its defective performance.⁴⁴³ It concluded that

... the Award is based more on a sort of general equity than on positive law (and in particular French civil law) or precise contractual provisions, ...⁴⁴⁴

Therefore, in the *ad hoc* Committee’s opinion, the Award’s passages on the evaluation of the respective obligations or debts contain little in the way of legal reasoning but are based on an “equitable estimate”.⁴⁴⁵

The principle that a decision based on equity without authorization may constitute an excess of powers in the sense of Art. 52(1)(b) was confirmed by the *ad hoc* Committee in *MINE v. Guinea*. It pointed out that, unless the parties had agreed on a decision *ex aequo et bono*, a decision not based on any law would constitute a derogation from the Tribunal’s terms of reference.⁴⁴⁶ In the instant case, no such decision was found to exist (see para. 17 *supra*).

In *Zhinvali v. Georgia*, the Tribunal found that in the absence of a qualifying investment it had no jurisdiction over the case. It observed that the Claimant may find this result unfair and painful and added:

But the Tribunal is without any special equitable powers. Article 42(3) of the ICSID Convention provides that an ICSID tribunal only has “the power to decide a dispute *ex aequo et bono* if the parties so agree”, and here the parties have *not* so agreed. Consequently, the Tribunal can only seek fairly and properly to apply the governing law to the facts before it.⁴⁴⁷

One might add that even an agreement on the tribunal’s power to decide *ex aequo et bono* would not have cured a lack of jurisdiction.

3. The Relationship of Equity to Law

a) Application of Equity and Law

The power to decide *ex aequo et bono* gives the tribunal a certain element of discretion not only with regard to the selection of the principles of equity to be

442 At para. 79.

443 *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 72.

444 *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, para. 163.

445 At para. 176.

446 *MINE v. Guinea*, Decision on Annulment, 22 December 1989, para. 5.03.

447 *Zhinvali v. Georgia*, Award, 24 January 2003, para. 418. Italics original.

applied but also insofar as it is open to the tribunal to apply rules of law after all. In other words, Art. 42(3) is permissive and does not preclude the application of law. The Convention's *travaux préparatoires* show that the power to apply equity does not prevent the application of law (History, Vol. II, pp. 420, 570). Therefore, the tribunal is free to apply the law, to depart from it or to apply rules of law which would not be applicable otherwise under Art. 42(1). Just as a clause may authorize the tribunal to decide only certain matters *ex aequo et bono* (see para. 256 *supra*), the tribunal may choose to decide some of the matters which are within an authorization under Art. 42(3) in accordance with equity and others with law.⁴⁴⁸

267 In *Benvenuti & Bonfant v. Congo*, the Tribunal was authorized by the parties to decide *ex aequo et bono* (see para. 259 *supra*). This did not stop the Tribunal from looking at rules of law.⁴⁴⁹ Thus it found that compensation in case of nationalization was mandated by the host State's law, by international law as well as by equity (see para. 208 *supra*). It proceeded to determine the quantum of damages *ex aequo et bono*.⁴⁵⁰ The interplay of equity and law is particularly well illustrated by the following passage:

... B&B claimed interest at the rate of 15% a year on all sums awarded to it.

4.98. The Tribunal does not consider it possible to uphold this claim seeing as the law applicable, Congolese Law, lays down a significantly lower rate of interest. The Tribunal observes, however, that the Government, in its Memorial in Defence, suggested a rate of interest of 10% in connection with its counterclaim. By virtue of its power to rule *ex aequo et bono*, the Tribunal considers it equitable to adopt this rate in relation to the compensation awarded to B&B.⁴⁵¹

268 In *Atlantic Triton v. Guinea*, the agreement between the parties contained a choice of law clause referring to the law of the host State (see para. 26 *supra*) as well as a clause authorizing decision *ex aequo et bono* (see para. 255 *supra*).⁴⁵² The Tribunal proceeded to apply at times the law of Guinea⁴⁵³ and at times equitable principles.⁴⁵⁴

b) Equity Within the Law

269 Not every invocation of equitable considerations amounts to a decision *ex aequo et bono*. A tribunal may take note of equitable standards provided for by the law or may exercise some discretion in applying rules of law on the basis of justice and fairness.⁴⁵⁵ In other words, a decision *ex aequo et bono* must be distinguished from equity within the law. In *Amco v. Indonesia*, the *ad hoc* Committee said:

448 *Amerasinghe, C. F.*, How to Use the International Centre for Settlement of Investment Disputes by Reference to Its Model Clauses, 13 *Indian Journal of International Law* 530 at 545 (1973).

449 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, paras. 4.5–4.6.

450 At para. 4.65.

451 At paras. 4.97–4.98.

452 *Atlantic Triton v. Guinea*, Award, 21 April 1986, 3 *ICSID Reports* 17, 19, 23.

453 At pp. 33, 36.

454 At pp. 30, 32, 42.

455 *Lauterpacht, E.*, Aspects of the Administration of International Justice 120 *et seq.* (1991); *Di Pietro*, *Applicable Law*, p. 271.

26. Neither does the *ad hoc* Committee consider that any mention of “equitable consideration” in the Award necessarily amounts to a decision *ex aequo et bono* and a manifest excess of power on the part of the Tribunal. Equitable considerations may indeed form part of the law to be applied by the Tribunal, whether that be the law of Indonesia or international law.

...

28. The *ad hoc* Committee thus believes that invocation of equitable considerations is not properly regarded as automatically equivalent to a decision *ex aequo et bono* . . .⁴⁵⁶

The Committee also rejected the contention that the International Court of Justice had applied equitable considerations only in the context of delimitation of maritime boundaries.⁴⁵⁷

The fact that a tribunal may take equitable considerations into account without deciding *ex aequo et bono* was also recognized in the ICSID Additional Facility case of *Tecmed v. Mexico*. The Tribunal found that an

Arbitral Tribunal may consider general equitable principles when setting the compensation owed to the Claimant, without thereby assuming the role of an arbitrator *ex aequo et bono*.⁴⁵⁸

Similarly, the *ad hoc* Committee in *MTD v. Chile* pointed out that considerations of fairness and balancing of interests did not necessarily amount to decision *ex aequo et bono*. The Committee said:

It should be noted that Article 42(3) of the ICSID Convention concerns the determination *ex aequo et bono* of disputes, i.e., of the substantial matter referred to the tribunal. This is different from taking into account considerations of fairness in applying the law. For example, individual rules of law will often require fairness or a balancing of interests to be taken to account. This is the case with the fair and equitable treatment standard itself, the standard the Tribunal was required to apply.⁴⁵⁹

4. Limits on Equity

The authorization by the parties to go beyond rules of law and to apply equitable principles of justice does not give the tribunal unlimited discretion. The tribunal may not act arbitrarily but must base its decision on objective and rational considerations which must be stated.⁴⁶⁰ The obligation of Art. 48(3) that the tribunal shall state the reasons underlying an award extends to decisions *ex aequo et bono*, although the burden of reasoning may be somewhat lighter than in the case of decisions based on law. Failure to state any reasons for a decision *ex aequo et*

456 *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, paras. 26, 28. See also the remark by the *ad hoc* Committee in *Klöckner v. Cameroon* cited in paras. 262, 263 *supra*, and the Dissenting Opinion to the Award in *SOABI v. Senegal*, 25 February 1988, 2 ICSID Reports 282.

457 At para. 27.

458 *Tecmed v. Mexico* (AF), Award, 29 May 2003, para. 190.

459 *MTD v. Chile*, Decision on Annulment, 21 March 2007, para. 48. Italics original.

460 *Broches*, The Convention, p. 394; *Hirsch*, The Arbitration Mechanism, pp. 151 *et seq.*

bono may expose the award to annulment under Art. 52(1)(e) (see Art. 48, para. 57; Art. 52, para. 349).

273 In addition, certain fundamental principles of international law which may be summarized as international public policy and *ius cogens* (see paras. 49–52 *supra*) constitute an outer margin for the tribunal's discretion. Even an award *ex aequo et bono* may not violate peremptory rules such as the prohibition of slavery and terrorism and other grave violations of human rights.

274 The domestic law of some States does not permit arbitration *ex aequo et bono*. Some commentators have therefore concluded that, when a tribunal sits in such a country, it lacks the power to decide on the basis of equity rather than law.⁴⁶¹ Such a conclusion is unwarranted in the case of ICSID arbitration. Arbitration under the ICSID Convention is truly international and free from the interference of national rules.⁴⁶² The choice of an ICSID tribunal's place or places of proceedings is purely a matter of convenience and has no impact on the applicable law (see para. 62 *supra*).

275 Even if parties combine an authorization to decide *ex aequo et bono* with the choice of a law (see paras. 256, 266 *supra*) that prohibits *ex aequo et bono* decisions, they would not affect the tribunal's power to use equitable principles. Art. 42(3) provides that the tribunal's power to decide *ex aequo et bono* is not prejudiced by the selection of the proper law under Art. 42(1). In other words, an agreement authorizing the tribunal to decide equitably under Art. 42(3) would to that extent derogate from contrary provisions of the law otherwise applicable under Art. 42(1). This principle applies irrespective of whether the governing law applies by virtue of the first or second sentence of Art. 42(1). By contrast, Art. 54(2) of the Arbitration (Additional Facility) Rules provides that a decision *ex aequo et bono* not only requires express authorization by the parties but also the permission of the law applicable to the arbitration.

5. Decisions *ex aequo et bono* by ICSID Tribunals

276 The practice of ICSID tribunals acting under an agreed authorization to decide *ex aequo et bono* is restricted to two known cases.⁴⁶³ Nevertheless, it may be worthwhile to examine briefly the issues that the two tribunals chose to decide in accordance with equitable principles.⁴⁶⁴

461 *Bouchez, L. J.*, The Prospects for International Arbitration: Disputes between States and Private Enterprises, in: *International Arbitration: Past and Prospects* (Soons, A. H. A. ed.) 109 at 138 (1990).

462 *Goldman*, Le droit applicable, p. 140; *Hirsch*, The Arbitration Mechanism, p. 151.

463 See also an *obiter dictum* in the Dissenting Opinion to the Award in *AAPL v. Sri Lanka*, 27 June 1990, 4 ICSID Reports 319, where the Arbitrator points out that the claim must be dismissed on strict legal grounds but that, if the Tribunal were competent to decide *ex aequo et bono*, he would recommend an *ex gratia* amount.

464 See also *Schreuer*, Decisions Ex Aequo et Bono, pp. 44 *et seq.*

In *Benvenuti & Bonfant v. Congo* (see paras. 259, 267 *supra*), the Tribunal specifically described its decision as being “determined *ex aequo et bono*” or as “equitable” on the following points: **277**

- the quantum of damages for the nationalization without compensation;⁴⁶⁵
- the award of a sum for a claim that was not contested by the Respondent;⁴⁶⁶
- the award of a relatively small amount as compensation for *préjudice moral*;⁴⁶⁷
- the rate of interest on all sums awarded⁴⁶⁸ (see para. 267 *supra*);
- the dates from which interest was to run;⁴⁶⁹ and
- the award of a special amount to cover additional procedural costs caused by the Respondent’s delay in participating in the proceedings.⁴⁷⁰

In *Atlantic Triton v. Guinea* (see paras. 255, 268 *supra*), the Tribunal noted that a subcontractor had initiated court proceedings in Norway against the Claimant and the Respondent in respect of one of the claims between the parties. Therefore, in order to avoid Guinea being ordered to pay twice, the Tribunal subjected payment for this claim to the condition that Atlantic Triton produce a bank guarantee. The Tribunal made this ruling despite the fact that this point was not raised during argument and described it as being made *ex aequo et bono*.⁴⁷¹ In addition, the Tribunal set interest on this amount “equitably” at 9 per cent seeing that the parties had chosen the US Dollar as their monetary unit and that this was the current inter-bank interest rate in the United States.⁴⁷² Finally, with regard to outstanding management fees, the Tribunal found that the services were reduced after a while and then terminated altogether during the period in question. Moreover, the Claimant had not exercised the necessary diligence in performing its functions. For these reasons, the Tribunal, ruling *ex aequo et bono*, awarded a lump sum of less than one third of what would have been due otherwise.⁴⁷³ The Tribunal reiterated that it was acting *ex aequo et bono* before the final dispositive of the award.⁴⁷⁴ **278**

This brief survey indicates that, in the majority of instances, rulings *ex aequo et bono* were used to calculate or estimate the amounts of monetary compensation including the interest due on them. There is no clear instance in which a tribunal disregarded rules of law in favour of equitable principles. A possible exception to this observation is the award of special procedural costs in *Benvenuti & Bonfant v. Congo* (see para. 277 *supra*) seeing that the agreement between the parties had provided that the costs of the arbitration were to be shared equally. **279**

465 *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, para. 4.65.

466 At para. 4.82.

467 At para. 4.96.

468 At para. 4.98.

469 At paras. 4.99–4.100.

470 At paras. 4.127–4.129.

471 *Atlantic Triton v. Guinea*, Award, 21 April 1986, 3 ICSID Reports 30.

472 *Loc. cit.*

473 At pp. 31/2.

474 At p. 42.