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Rationalizing applicable law in investor-State disputes in absence of express choice of law under Article 42 (1) of ICSID Convention

PART I

Article 42 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) determines the powers of an arbitral tribunal constituted under the ICSID Convention as to applicable law in investor-State disputes.

Paragraph 1 of the Article has been subject of varying interpretation in both practice and doctrine, especially as to the determination of applicable law in cases of absence of express choice of law. The interpretation of the Article oscillates from absolute focus on national law of host State to complete preference of international law. However, it is possible to rationalize the scope of applicable law under Article 42 (1) in light of the model factual scenarios which may be brought to the ICSID dispute resolution mechanism.

The present diversity of views as to the proper understanding of Article 42 (1) is engendered by the attempt to reach an overarching and absolute interpretation of applicable law "wrapping" domestic law and international law in an indivisible package. However, it is hereby proposed that Article 42 (1) should rather be interpreted as delimiting the general array of powers provided to ICSID tribunals, i.e. the law that *may be* applied, while the concrete law *applicable* to a particular case would depend on the circumstances of this case and, most of all, the legal basis of the aggrieved investor's claim so that the tribunals may apply either domestic or international law, or both. The substantive grounds for the Investor's claim lie in a substantive law already tightly linked to the facts of the case. Hence, there is a trigger prior to the stage where the tribunal exercises its powers under Article 42 (1) in the absence of express choice of law and this is the claim brought by the investor and its cause of action, its substantive law basis – which actually incorporates his substantive rights that the investor claims to be prejudiced. Below follows an analysis of three factual situations which predetermine what would be the proper law determinable under Article 42 (1).

1. Scenario 1: basis of investor's claim is a national law provision of the host State.

1.1 An investor-State dispute may arise out of national legislation, for instance laws enacting incentives to investors. In such case the rights of the investor and the respective obligations of the State stem from the domestic law of the host State. Without surprise the proper applicable law would be the national law of the host state.

This may be supported by an argument borrowed from the area of private international law (conflict of laws). In a situation involving a foreign entity making investment in another country the relations between the investor and the host State has to be connected to certain legal order. Although usually located on the territory one country, the investment apparently features an international element which triggers the relevance of private international law techniques. The variety of types of rights the investor has acquired – real estate, stock/debentures, contractual *in personam* rights, intellectual property, etc., would all be granted by the national law of the host State and hence the investment would be linked in closest manner to the domestic law of the host State. On basis of these closest connecting factors the *lex proximus* should be the law of the host State.

Would there be any application of international law in this scenario? It can be argued that international law may be applicable but only to the extent it is a part of the municipal law of the host State. In such regard the starting point should be to determine the position of the host State to international law – whether a monist or dualist one, and in what manner rules of international law become incorporated in its national law. Each domestic law lays down the hierarchical place of international law, both treaties and customary international law, within its structure.

A number of tribunals (and doctrine) have considered that international law may have corrective role, derogating contrary provisions of national law, or subsidiary role if national law features lacunae to be filled by international law. However, if a national law features lacunae, the proper way to address the issue would be to seek sources of solution within the body of rules (and principles) of national law instead of direct recourse to public international law. Therefore, it is more reasonable to adopt a view based on the relevance of international law as incorporated within the host State law, as would be demonstrated by the review of case law.

1.2. Case law examples

In *SPP v Arab Republic of Egypt (ARB/84/3)* the dispute arose out of provisions of the national legislation of Egypt with respect to a hotel construction project adjacent to the pyramids near Cairo. The legal basis of investor's claim was the Egyptian Law No. 43 of 1974. When considering the ambit of applicable law (paras 74-80 of the award) the Tribunal acknowledged the applicability of national law of the host State. However, the Tribunal did not rule out application of rules of international law. As a theoretical consideration, it was suggested that international law would enter into play in case of lacunae to be filled by it. Moreover, the Tribunal applied rules regarding attribution of acts and omissions of State from the area of State responsibility as customary international law but it explicitly recognised that acts of State officials are in breach of principles of international law, thus considering two separate grounds for liability of Egypt – its national legislation, which the Tribunal applied, and potential violation of international standards (e.g. from customary international law), which streamlines the role of application of international law rules such as those on attribution from the area of State responsibility.

Similarly, in *Tradex Hellas v Republic of Albania (ARB/94/2)*, the cause of action of the investor was Albanian Law No. 7764 of 1993. The Tribunal reasoned (para 69 of the award) that the proper applicable law should be the law of the host State. International law could have been invoked only to the extent of interpretation of concepts such as expropriation that were already incorporated in the national legislation of the host State (Albania).

The decision of the Annulment Committee in *Wena Hotels v Arab Republic of Egypt (ARB/98/4)* can be interpreted as an argument in the same vein. The Committee had to establish the relationship between domestic Egyptian law and application of international law and whether the Tribunal in the case made manifestly erroneous application of law. The Committee based its conclusions regarding the role of international law upon Egyptian constitution which granted priority of international law instruments over national legislation. Therefore it may be construed that the applicability of rules of international law does not draw upon the postulate of Article 42 (1) alone but it is triggered by the place of international law within the system of particular domestic law, as a result of which the Tribunal may make recourse to it. In such a case international law can have a corrective, supplementary or controlling function – but this would be so by virtue of international law's position as being incorporated in municipal law, and not merely due to the second sentence of Article 42 (1).

2. Scenario 2: basis of investor's claim is a direct "nexus" with the host State

2.1. This point first begs clarification of the term "nexus". A "nexus" may be understood as a contractual link or a unilateral grant of rights, i.e. license, concession, authorization, permit, etc. in both cases establishing direct connection between the investor and the State. The analysis of this situation is to a significant extent similar to the one in Scenario 2. The primary applicable rules would be those particular rules governing the nexus-based relationship. Since the nexus is a national law instrument, any relevant rules of national law should be applied as well.

It is possible that the parties to a contractual nexus, i.e. the investor and the State, choose applicable law different from the national law of the host State, given that this national law allows so. This choice of law, if properly made, seems to divert the applicable law under Article 42 (1) away from the national law of the host State.

However, two possible corrections may be pertinent in this regard:

First, by virtue of a general technique of private international law, the choice of law of the nexus would not possibly derogate from cornerstone provisions of host State law, e.g. overriding mandatory_rules, public policy, etc. so that these may be relevant to the application of the chosen law and thus, again, bring host State national law to the front.

Second, even if the parties to the nexus (most often a contract) opt for law applicable to the nexus other than that of the host State, the relationship between the investor and the State yet remains in closest connection to the host State and, therefore, its national law. If the *lex proximus* is in fact the law of the host State, this would suggest to the arbitral tribunal that the national law should be applied in its entirety without regard to the choice of law stipulated in the nexus.

The role of international law in such a situation would be as in Scenario 1.