

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

# DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR  
SETTLEMENT OF INVESTMENT DISPUTES

2.6 Applicable Law



**UNITED NATIONS**  
New York and Geneva, 2003

## NOTE

**The Course on Dispute Settlement in International Trade, Investment and Intellectual Property** consists of forty modules.

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## OVERVIEW

This Module gives an overview of the most important legal questions that arise in connection with the applicable law under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention).

The substantive rules of law for solving a dispute are not provided by the ICSID Convention. The Convention grants autonomy to the parties in choosing the law that ought to be applied to solve their dispute. The parties can also allow the tribunal to decide *ex aequo et bono*. In the absence of an agreement, the ICSID Convention designates the host State's law in conjunction with international law as the applicable law. The tribunal may not return a finding of *non liquet* if it is unable to discover appropriate rules of law.

Sometimes, difficulties have arisen in identifying the parties' agreement on choice of law. Questions have also been raised concerning the relationship between international law and domestic law.

The ICSID Convention provides the possibility of annulling awards that do not apply the proper law.

## OBJECTIVES

Upon completion of this booklet the reader should be able to:

- Understand the significance of the applicable law in ICSID arbitration.
- Discuss the principle of party autonomy in the choice of law.
- Describe the ways in which the parties may agree on the proper law.
- Define the ICSID Convention's rule on applicable law in the absence of party agreement.
- Analyse the relationship of international and domestic law in ICSID practice.
- Explain the prohibition of *non liquet*.
- Identify the requirements for a decision based on equity rather than law.
- Appreciate the possible consequences of a non-application of the proper law.



# 1. APPLICABLE LAW: GENERAL APPROACH

## Introduction

Arbitration awards are always based on substantive rules of law, applicable to the relationship between the parties. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter the Convention or the ICSID Convention) does not provide those substantive rules. It just establishes a procedural framework for the settlement of disputes.

However, Article 42 of the Convention sets forth a mechanism in accordance with which the tribunal is to select the appropriate rules of law for the particular dispute.

This mechanism combines flexibility with certainty. Flexibility is provided by granting the parties the freedom to choose the applicable law. Certainty is provided by ensuring that, if the parties fail to make that choice, the tribunal will find appropriate rules in order to solve the dispute (the host State's law in conjunction with international law). A finding of *non liquet* by the tribunal is prohibited.

## Article 42

Article 42 of ICSID Convention provides:

- (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.*

## Scope

Article 42 of the Convention only addresses the substantive law to be applied. Matters of procedure are not governed by Article 42.

In fact, Article 44 of the Convention states that the arbitration procedure is regulated exhaustively by the Convention itself and by the rules adopted under it, subject to any agreement by the parties. (see Module 2.7)

Likewise, matters relating to the tribunal's jurisdiction under Article 25 are not governed by Article 42.

In *CSOB v. Slovakia*, jurisdiction was based on an agreement between the parties. The Tribunal held:

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



The rule of Article 42 also does not govern the nationality of the investor. The nationality of a natural person is settled primarily by the law of the State whose nationality is claimed. The nationality of a juridical person is established by the principle of incorporation or seat of the corporation in question. The law of the investor's nationality also rules the investor's status and legal capacity.<sup>2</sup>

In the Decision on Jurisdiction in the Resubmitted Case *Amco v. Indonesia*<sup>3</sup>, Amco Asia, a company registered in Delaware, was dissolved under the laws of Delaware one month after the rendering of the first Award. Indonesia held that under Indonesian law, which was applicable in accordance with Article 42(1) second sentence, once a limited liability corporation was dissolved, it ceased to exist for any purpose.<sup>4</sup> The Tribunal disagreed with Indonesia's argument on applicable law stating that:

*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<sup>5</sup>.*

### Methodology

First of all, the tribunal should verify whether the parties have chosen a system of law or individual rules of law or principles of law, in accordance with Article 42(1) first sentence. Only if the parties have not agreed on applicable rules of law, the tribunal will fall back on the residual rule referring it to the law of the host State and to international law (Article 42(1) second sentence). The method described is designed to avoid any uncertainty of law, in order to leave no place for silence or obscurity of the law making a decision impossible (Article 42(2)).

### Summary:

- **The substantive rules of law for solving the dispute between the parties are not provided by the ICSID Convention.**
- **The parties are free to choose the applicable substantive law that the tribunal should apply to solve the dispute.**
- **If the parties have not agreed on a choice of law, the tribunal will apply the host State's law and international law.**

<sup>1</sup> CSOB v. Slovakia, *Decision on Jurisdiction*, 24 May 1999, 14 ICSID Review—Foreign Investment Law Journal 251, 263/4 (1999).

<sup>2</sup> Schreuer, C., *The ICSID Convention: A Commentary*, p. 554 (2001).

<sup>3</sup> Resubmitted Case: *Decision on Jurisdiction*, 10 May 1988, 1 ICSID Reports 543.

<sup>4</sup> At p. 561.

<sup>5</sup> At p. 562.

## 2. GENERAL RULE: THE AUTONOMY OF THE PARTIES

### Freedom of choice

The principle of autonomy of the parties granted by the ICSID Convention implies the freedom of the parties to choose the applicable law by agreement. Like any other arbitral tribunal, ICSID tribunals are bound by the parties' agreement in this matter.

In accordance with Article 42(1) first sentence, an ICSID tribunal

*shall decide a dispute in accordance with such rules of law as may be agreed by the parties.*

The parties are free to decide on the substantive law that the tribunal should apply to settle their dispute. They can also leave the matter to the residual rule of Article 42(1) second sentence<sup>6</sup>.

### Law of the host State

The law of the host State is the typical choice for a contractual relationship concerning an investment.

*In Mobil Oil v. New Zealand*<sup>7</sup>, the parties had agreed that  
*an arbitral Tribunal shall apply the law of New Zealand*

### Law of the investor's home country or of a third State

The selection of the law of the investor's home country or of a third State is unusual. Such choices would create difficulties if the investment involves activities that are closely related to the host State's legal system like administrative law, labour law and tax law.

An exception to this observation is the well-known practice to submit loan contracts to the law of the lender's State or to the law of a third State that has an important financial centre.

A stipulation for the application of the law of the investor's home country appeared in *Colt Industries v. The Republic of Korea*<sup>8</sup>. In that singular case, the investment involved technical and licensing agreements that seemed most closely connected with the licensor's home country.

### Investment agreement as a self-contained legal system

An inadvisable method to choose the applicable law is to consider the agreement as a self-contained legal system isolated from any extraneous system of law. This choice may cause significant practical problems when the tribunal is unable to find any guidance on a particular issue in the agreement itself. In such case,

<sup>6</sup> Shihata, I. F. and Parra, A. R., *Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*, 9 *ICSID Review—Foreign Investment Law Journal* 183, p. 189 (1994).

<sup>7</sup> *Attorney-General v. Mobil Oil NZ Ltd., New Zealand, High Court, 1 July 1987*, 4 *ICSID Reports* 123.

<sup>8</sup> *This case was settled and discontinued with no published record of the proceedings.*

it may resort to the second sentence of Article 42(1) and apply the law of the Contracting State and such rules of international law as may be applicable.

#### Rules of law

Article 42(1) first sentence refers to “rules of law” rather than systems of law. Consequently, it is generally accepted that the parties are not restricted to accepting a complete legal system of law *tel quel* but are free to combine rules of diverse origin.

Therefore, choice of law clauses may refer to various legal systems cumulatively, or subject different parts of the agreement to different systems of law, a process called “*dépeçage*”. The parties are also allowed to set aside certain aspects of a chosen system of law from its application to the relationship, or to declare applicable rules derived from a treaty not yet in force or another non-binding instrument.

#### Renvoi under Article 42(1) first sentence

“*Renvoi*” is a process by which a selected system of law in turn includes rules on the conflict of laws that make reference to another legal system. Since the first sentence of Article 42(1) makes no reference to rules on the conflict of laws, as is the case in its second sentence, it stands to reason that an explicit choice of law only applies to the substantive rules of the selected law, but not to the conflict of laws rules included therein.

#### Choice of international law

In order to protect the investor's interests in view of the uncertainties of the host State's law, the parties sometimes decide to internationalize their agreement. This purpose is accomplished by making a reference to international law or to general principles of law, jointly with the host State's law.

Referring only to international law and excluding any reference to a domestic law is not advisable. The law thus chosen may lack in clarity and technical detail. Nevertheless, many multilateral treaties providing for ICSID arbitration, including NAFTA and the Energy Charter Treaty, contain clauses on applicable law that only mention the corresponding treaty and rules of international law.

For example, the Energy Charter Treaty establishes in its Article 26:

*(6) A Tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law*<sup>9</sup>.

In *AGIP v. Congo*, the parties had agreed on the application of Congolese law supplemented by the principles of international law. 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:

<sup>9</sup> 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).

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.<sup>83</sup> 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<sup>10</sup>.

**International law as part of domestic law**

International law is frequently incorporated into domestic law through a variety of techniques<sup>11</sup>. 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.

But it would not be wise just to rely on the incorporation of international law into a domestic law chosen by the parties. The status of international law under domestic constitutions is by no means uniform. Subsequent domestic enactments may take precedence over international law. Certain parts of international law may be regarded as non-self-executing. Therefore, an investor looking for protection in international law should not simply rely on references to international law in the law of the host State. The investor should insist either on a choice of law clause that includes international law or on the application of the second sentence of Article 42(1).

**International law in the absence of its choice**

The question remains, whether international law will be taken into account by an ICSID tribunal if it is not mentioned in an agreement on choice of law. There are good reasons for the proposition that there is at least some place for international law even in the presence of an agreement on choice of law which does not mention it.

In *SPP v. Egypt*<sup>12</sup>, there was disagreement as to whether a choice of Egyptian law had been made by the Parties and, consequently, as to whether international law was applicable in conformity with the second sentence of Article 42(1). The Tribunal declared this disagreement immaterial, holding that international law was applicable either way:

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, 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.<sup>13</sup>

<sup>10</sup> Award, 30 November 1979, 1 ICSID Reports 323.

<sup>11</sup> Oppenheim's International Law, 9th edition, 54 et seq. (1992).

<sup>12</sup> Award, 20 May 1992, 3 ICSID Reports 189.

<sup>13</sup> At p. 207.

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:

*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.<sup>14</sup>*

This decision shows a reluctance to abandon international law in favour of the host State's domestic law. The complete exclusion of international law as a consequence of an agreed choice of law containing only a domestic legal system would lead to undesirable consequences. It would mean that an ICSID tribunal would have to uphold discriminatory and arbitrary actions 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 conform to the applicable domestic law. It would mean that a foreign investor, 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 be contrary to the goal of the Convention to stimulate investment through the creation of a favourable investment climate.<sup>15</sup>

**International minimum standard**

Therefore, international minimum standards should be preserved, even in the absence of a reference to international law in a choice of law clause. The mandatory rules of international law which provide an international minimum standard of protection for aliens, exist independently of any choice of law. Their obligatory nature is not open to the disposition of the parties.

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.

**Summary:**

- **The principle of autonomy of the parties implies the freedom to choose the substantive law to settle their disputes.**
- **The parties may combine provisions from different domestic or international legal systems.**
- **Even if the parties do not include international law in their agreement on applicable law, the tribunal will preserve the application of international minimum standards.**

<sup>14</sup> At p. 208.

<sup>15</sup> Report of the Executive Directors, para. 9, 1 ICSID Reports 25.

### 3. WAYS OF CHOOSING THE APPLICABLE LAW

The choice of law open to the parties may be exercised in one of several ways.

#### Direct agreement

One is a direct agreement between the parties, which may be reached before or after the institution of proceedings. The normal way to agree on a choice of law is through a clause in the initial investment agreement between the host State and the investor.

The 1993 ICSID Model Clauses offers the following sample for a direct agreement on choice of law:

#### **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: . . . ].<sup>16</sup>*

In their agreement the parties may refer to domestic law, international law, a combination of domestic and international law, or a law frozen in time or subject to certain modifications. They are free to agree on rules of law defined as they choose.

#### Applicable law chosen in legislation or treaty

In some cases, the legislation or treaty providing for ICSID jurisdiction (see Module 2.3, Sections 3.-5.) includes a provision on applicable law. Such a provision is transformed into an agreement on choice of law by the parties upon the acceptance of jurisdiction by the investor.

#### Choice of law in BITs

Many bilateral investment treaties (BITs) contain choice of law clauses. These commonly include references to the BIT itself, the law of the Contracting State, the rules and principles of international law, and sometimes the provisions of a particular investment contract.

For example, article 10 of the Argentina/Netherlands BIT concluded in 1992, after providing for ICSID arbitration, established:

*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.<sup>17</sup>*

#### Time of agreement

Under the ICSID Convention, the parties' freedom to choose the applicable rules of law is not limited to the time of the conclusion of an investment agreement or even to the time that the dispute arises. The choice of law may

<sup>16</sup> 4 ICSID Reports 364.

<sup>17</sup> Argentina/Netherlands BIT, 20 October 1992, Investment Promotion and Protection Treaties, looseleaf, ICSID. Many BITs, especially of Latin American countries, contain similar clauses. See Fedax v. Venezuela, Award, 9 March 1998, 37 ILM 1391, 1396 (1998).

also be made by the parties in the course of the arbitration proceeding<sup>18</sup>. If no choice of law has been made by direct agreement, by legislation or by treaty by the time the arbitration is instituted, nothing precludes a subsequent agreement by the parties on applicable law.

In *Benvenuti & Bonfant v. Congo*, the parties reached an agreement in the course of the arbitration proceedings to authorize the Tribunal to rule *ex aequo et bono*<sup>19</sup>, a power which was accepted by the Tribunal<sup>20</sup>. While this agreement did not strictly relate to rules of law as provided in Article 42(1) first sentence, such an agreement reached in the course of the proceedings would be equally acceptable.

**Implied choice of law**

It is an open question whether, for purposes of Article 42(1) first sentence, the parties' agreement on applicable law must be expressed or may be implied from the facts and circumstances of the relationship<sup>21</sup>.

Article 42(1) of the ICSID Convention does not require that the parties' agreement must be in writing or even that it should be stated expressly.

But the choice of law, if implied, must be evidenced “with reasonable certainty” by the terms of the parties' contract or the circumstances of the case<sup>22</sup>.

**Choice of law by reference to domestic legislation**

For instance, the mere fact that jurisdiction is derived from a provision of the host State's law cannot be construed as a choice of law of the host State's law.

Also, the mere recital in a particular agreement of a provision of domestic law or even of a complete piece of legislation is not a reliable indication of a general choice of the domestic law concerned.

**Choice of law derived from parties' submissions**

Sometimes, the reliance by the parties on certain sources of law in their submissions before the tribunal is taken as an argument to support an implicit agreement on choice of law.

In *AAPL v. Sri Lanka*<sup>23</sup>, the Tribunal observed that the parties, not having concluded an arbitration agreement directly negotiated between them, had not had an opportunity to choose the applicable law in advance of the arbitration proceedings. Therefore, the choice of law process would materialize through the conduct of the Parties in the arbitration proceedings. An observation of this conduct led the Tribunal to conclude that:

<sup>18</sup> Shihata and Parra, *Applicable Substantive Law*, p. 201.

<sup>19</sup> *Award*, 15 August 1980, 1 ICSID Reports 342. 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 (p. 338). An agreement to this effect was formally reached by the Parties on 5 June 1979 and communicated to the Tribunal (p. 342).

<sup>20</sup> At pp. 349, 357 et seq.

<sup>21</sup> Schreuer, *Commentary*, p. 573.

<sup>22</sup> Shihata and Parra, *Applicable Substantive Law*, p. 190.

<sup>23</sup> *Award*, 27 June 1990, 4 ICSID Reports 250 at p. 256.

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

**Parties' submissions as confirmation of the chosen law**

In other situations the tribunal may reach an independent conclusion on choice of law but may take the parties' submissions as a confirmation of its own determination.

In *Amco v. Indonesia*<sup>24</sup> the Tribunal found that, since the Parties had not expressed an agreement as to rules of applicable law, Indonesian law and rules of international law were to be applied. The Tribunal found confirmation for this finding in the fact that both parties had not just failed to deny the applicability of these two systems of law but had, in fact, constantly referred to both of them.

**Summary:**

- **The parties can choose the applicable law through a direct agreement or through the operation of a choice of law clause in a treaty or legislation providing for ICSID arbitration.**
- **The choice of law may be exercised also after the institution of the arbitration proceedings.**
- **ICSID tribunals may recognize an implied choice of law. But the intention of the parties to exercise such choice should be clear.**

<sup>24</sup> 20 November 1984, 1 ICSID Reports 413.





## 4. STABILIZATION CLAUSES

### Risk of subsequent changes of law

When the parties choose the host State's domestic legal system, the foreign investor runs the risk of subsequent changes in that law. These changes may adversely affect the legal terms of the relationship.

Subsequent changes in the applicable law may have a severe impact on the investment. These may go as far as the termination of the contract and the expropriation of the investor's property.

Other changes in domestic laws are less dramatic but may still have a strong impact on the investment relationship. Changes in taxation, environmental standards, minimum wages and any other aspect of the regulatory structure in the investor's activities are typical examples of these situations.

### Stabilization clauses

One way to prevent the effect of subsequent changes is to introduce a stabilization clause into the investment agreement. Such a clause protects the investor from subsequent changes of the local law.

The State may still change its law, but a stabilization clause establishes a promise not to apply any adverse changes to the investor's operations or a promise to compensate the investor for any adverse consequences of such a change. In other words, from the investor's perspective, the law becomes frozen at the time of the contract.

In order to shield stabilization clauses against their unilateral abrogation through host State legislation, they are governed by international law, even if otherwise the chosen law is domestic law.

### ICSID Model Clause 10 of 1993

ICSID Model Clause 10 of 1993,<sup>25</sup> dealing with applicable law, suggests a 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".<sup>26</sup> Stabilization clauses are used frequently in contracts providing for ICSID arbitration.

### Non-comprehensive stabilization clauses

Stabilization clauses need not to be comprehensive, but may be employed selectively. It is perfectly conceivable to apply them to specific areas only. For example, in *Kaiser Bauxite v. Jamaica*, the principal agreement between the parties included a "no further tax" clause.<sup>27</sup>

### Absence of stabilization clauses

In the absence of a stabilization clause the chosen law will normally be applied as it evolves over time. Normal changes to the host State's legal system, which constitute adaptations to changing social, economic and technological conditions, will apply to existing investment relationships. These will usually

<sup>25</sup> 4 ICSID Reports 364.

<sup>26</sup> 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).

<sup>27</sup> ICSID Reports 297. The Tribunal did not reach the question of the clause's relevance.

involve changes of labour law, reasonable adjustments of tax law and the updating of technical safety and environmental standards.

The situation is different if the change in the legislation serves the purpose of defeating undertakings which have been made by the host State. Action taken through changes in the domestic law which is aimed at abrogating the contractual relationship or at establishing a framework under which the investor can no longer operate will not have to be accepted. The repudiation of the agreement or the confiscatory expropriation of the investor's property through subsequent law changes are clear examples of such a situation. The host State's freedom to legislate is limited by the minimum standards of protection mandated by international law.

**Summary:**

- **The parties can introduce stabilization clauses into their contract in order to avoid the adverse effects of subsequent changes in domestic legislation.**
- **Changes in domestic legislation that evidence the will of defeating previous undertakings are contrary to international law.**

## 5. ABSENCE OF AGREEMENT ON THE APPLICABLE LAW

### Residual rule of Article 42(1) second sentence

If the tribunal cannot find an agreement between the parties on the rules of law to be applied to the dispute, it should turn to the residual rule contained in the second sentence of Article 42(1). This provision says:

*... 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.*

### Absence of choice of law

In *Benvenuti & Bonfant v. Congo*<sup>28</sup> the determination that the parties had not reached an agreement on the applicable law was made by way of a search of the contractual documents which ruled the relationship. These documents did not contain an explicit choice of law clause.

Another method is to look for an implicit or indirect choice of law in the agreements or in the parties' later behavior as, for example, their submissions to the tribunal in the course of the proceedings.

### Incomplete agreement on choice of law

The provision of Article 42(1) second sentence may be applicable even if the parties have made an agreement on choice of law. If the parties have not made a complete agreement on the applicable law, leaving some aspects of the relationship without any legal answer in the chosen law, the only acceptable way in accordance with the prohibition of *non liquet* in Article 42(2) is to apply the residual rule of Article 42(1) second sentence.

### Applicability of the host State's law

The formula in the second sentence of Article 42(1) which includes the application of the law of the host State is unusual. Other instruments governing international arbitration are more open-ended if there is no agreement on applicable law. They give tribunals the power to apply the law they consider most appropriate.<sup>29</sup> In the Convention's drafting, representatives of capital-importing countries insisted that only the law of the host country should apply in the absence of agreement between the parties. The victory of this position is mitigated by the fact that, in most cases, the host State's law is also the one to which the investment relationship has the closest connexion and, therefore, would have applied under the general principles of the conflict of laws. Also, the host State's law will be subject to the corrective function of international law.

### Application of Article 42(1) second sentence

ICSID tribunals have applied the provision of Article 42(1) second sentence in several cases, where they were unable to find an agreement between the parties on the choice of law.

<sup>28</sup> Award, 15 August 1980, 1 ICSID Reports 349.

<sup>29</sup> See UNCITRAL Arbitration Rules Art. 33(1); Additional Facility Arbitration Rules Art. 55.

For instance, in *Amco v. Indonesia*, the Tribunal said:

*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.*<sup>30</sup>

In most cases, the tribunals proceeded to examine and apply the respective domestic systems of law.

For example, in *Benvenuti & Bonfant v. Congo* and *SOABI v. Senegal*, the Tribunals found that the corresponding host States' laws were strongly influenced by French law and relied on that law as a manner of determining the pertinent rules of the host State's domestic law.<sup>31</sup>

**Subsequent changes in the host State's Law**

Stabilization clauses will normally not appear when the parties have not addressed the question of choice of law. Therefore, as a general principle, the host State's law will be applicable as it changes over time.

**Renvoi**

The second sentence of Article 42(1) contains a renvoi provision which states "... (including its rules on the conflict of laws) ...". The purpose of this provision is to mitigate the reference to the law of the host State, in order to allow the application of another system of law, which may have a closer connection to the transaction.

**Summary:**

- **In the absence of a choice of law by the parties, the tribunal will apply the law of the host State and such rules of international law as may be applicable.**
- **The application of the host State's law in accordance with Article 42(1), second sentence includes its rules on the conflict of laws (renvoi provision).**

<sup>30</sup> Award, 20 November 1984, 1 ICSID Reports 452.

<sup>31</sup> 1 ICSID Reports 338, 349; 2 ICSID Reports 222 et seq., 229, 249 et seq., 257.

## 6. RULES OF INTERNATIONAL LAW

### Rules of international law

The residual rule of Article 42(1), second sentence refers to:

*...such rules of international law as may be applicable...<sup>32</sup>.*

Paragraph 40 of the Report of the Executive Directors to the Convention<sup>33</sup> states:

*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 (ICJ), allowance being made for the fact that Article 38 was designed to apply to inter-State disputes.<sup>34</sup>*

Therefore this provision directs ICSID tribunals to look at the full range of sources of international law in a similar way as the International Court of Justice.

### Treaties

Treaty law is one of the most relevant aspects of international law to be applied by ICSID tribunals.

First and foremost among treaties is a bilateral investment treaty (BIT) between the host State and the investor's home State. In addition, a number of multilateral treaties such as the NAFTA and the MERCOSUR Investment Protocols contain detailed rules concerning foreign investment.

All these treaties are specifically designed to govern the type of relationship which is likely to come before an ICSID tribunal and are part of the "rules of international law" mentioned in Article 42(1) second sentence of the Convention.

<sup>32</sup> This passage 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. 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. 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. The difference between rules and principles of international law does not seem to have created major difficulties for Tribunals. See Schreuer, *Commentary*, p. 65.

<sup>33</sup> *History*, Vol. II, p. 962, 1029.

<sup>34</sup> 1 ICSID Reports 31. 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.”

The large and rapidly growing number of BITs and multilateral treaties dealing with investment make them the most important source of international law for ICSID tribunals or, as decided in *APL v. Sri Lanka*<sup>35</sup>, the primary source of applicable legal rules.

Other treaties may also become relevant in ICSID arbitration.

For instance, in *SPP v. Egypt*, the 1972 UNESCO Convention for the Protection of the World Cultural and Natural Heritage played a key role in the dispute<sup>36</sup>.

### **Customary international law**

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.

ICSID tribunals have frequently applied rules of customary international law either under the first or second sentence of Article 42(1):

In *Benvenuti & Bonfant v. Congo*, the Tribunal held that the principle of compensation in case of nationalization constitutes one of the generally recognized principles of international law.<sup>37</sup>

In *Amco v. Indonesia*, the Tribunal relied on the principle of respect for acquired rights in connexion with the authorization to invest which the Claimant had received from the Respondent.<sup>38</sup>

In *LETCO v. Liberia*, the Tribunal held that for a nationalization to be lawful, it would have to be based on a legislative enactment, taken for a bona fide public purpose, be non-discriminatory and be accompanied by appropriate compensation.<sup>39</sup>

### **General principles of law**

General principles of law are found through a process of comparative law whereby features common to domestic legal systems are established. General principles of law are particularly useful in areas of the law which involve non-State actors such as investment relationships and are an important source of international law in ICSID cases. Among those general principles of law usually recognized by ICSID tribunals are the general principles of contract law<sup>40</sup> including *pacta sunt servanda* and the *exceptio non adimpleti contractus*,<sup>41</sup>

<sup>36</sup> Award, 20 May 1992, 3 ICSID Reports 206/7.

<sup>37</sup> Award, 15 August 1980, 1 ICSID Reports 357.

<sup>38</sup> Award, 20 November 1984, 1 ICSID Reports 493.

<sup>39</sup> Award, 31 March 1986, 2 ICSID Reports 366.

<sup>40</sup> *Amco v. Indonesia*, Award, 20 November 1984, 1 ICSID Reports 461 et seq.

<sup>41</sup> *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 61 et seq.

estoppel,<sup>42</sup> unjust enrichment,<sup>43</sup> full compensation of prejudice resulting from a failure to fulfill contractual obligations,<sup>44</sup> general principles of due process,<sup>45</sup> the claimant bears the burden of proof<sup>46</sup> and *res judicata*.<sup>47</sup>

In addition, ICSID tribunals have relied heavily on general principles of law in the valuation of damages.

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”<sup>48</sup>. The *Ad hoc* Committee took these allusions as a reference to general principles of law.<sup>49</sup> In annulling the Award, it deplored the absence of any authority for these general principles and concluded that the Award’s reasoning seemed more like a simple reference to equity.

#### Judicial decisions

ICSID tribunals rely heavily on previous international judicial decisions when dealing with questions of international law. This includes, in particular, previous decisions of ICSID tribunals.

#### Writings

Like other courts and arbitration tribunals, ICSID tribunals and *Ad hoc* Committees also rely frequently on academic writings on various points of international law.

#### Resolutions and guidelines

In addition to the classical sources of international law, ICSID tribunals have also referred on occasions to resolutions of the General Assembly on questions such as nationalization.<sup>50</sup> The World Bank Guidelines on the Treatment of Foreign Direct Investment<sup>51</sup> is another non-binding instrument that is of potential value in ICSID arbitration.

<sup>42</sup> *Amco v. Indonesia, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 407/8; Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 606; Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 ICSID Reports 140/1; SPP v. Egypt, Decision on Jurisdiction, 27 November 1985, 3 ICSID Reports 123.*

<sup>43</sup> *Amco v. Indonesia, Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 607/8; SPP v. Egypt, Award, 20 May 1992, 3 ICSID Reports 246/7.*

<sup>44</sup> *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 498 et seq.*

<sup>45</sup> *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 472/3; Decision on Annulment, 16 May 1986, 1 ICSID Reports 529/30.*

<sup>46</sup> *AAPL v. Sri Lanka, Award, 27 June 1990, 4 ICSID Reports 272; Tradex v. Albania, Award, 29 April 1999, 14 ICSID Review—Foreign Investment Law Journal 197, 219 (1999).*

<sup>47</sup> *Amco v. Indonesia, Resubmitted Case: Jurisdiction, 10 May 1988, 1 ICSID Reports 548 et seq.*

<sup>48</sup> *Award, 21 October 1983, 2 ICSID Reports 59.*

<sup>49</sup> *Decision on Annulment, 3 May 1985, 2 ICSID Reports 121/2.*



These non-binding instruments do not necessarily reflect “rules of international law” as provided in Article 42(1). However, they may become part of the applicable law as a consequence of their incorporation into an agreement on choice of law under the first sentence of Article 42(1) or as a supplementary source in the application of rules of law.

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<sup>50</sup> *Amco v. Indonesia, Award, 20 November 1984, 1 ICSID Reports 466; LETCO v. Liberia, Award, 31 March 1986, 2 ICSID Reports 366; SPP v. Egypt, Dissenting Opinion to Award, 2 May 1992, 3 ICSID Reports 254/5.*

<sup>51</sup> *Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, 31 ILM 1363 (1992).*

## 7. THE RELATIONSHIP OF INTERNATIONAL AND DOMESTIC LAW

### Hierarchy of norms

The relationship of international law to the host State's domestic law has turned out to be a complex question. During the drafting of the Convention, it was made clear that international law would prevail where the host State's domestic law violated international law. At the same time, an important role for international law was seen in the filling of gaps in the host State's law.

The formula of the supplemental and corrective effect of international law has since been accepted. The function of international law is to close any gaps in domestic law as well as to remedy any violations of international law which may arise through the application of the host State's law.

### Parallel application of international and domestic law

In earlier ICSID 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, as in *Adriano Gardella v. Côte d'Ivoire*<sup>52</sup> or the original award in *Klöckner v. Cameroon*,<sup>53</sup> 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.

### Supplemental and corrective function of international law

In later decisions the tribunals entered into a more careful discussion of the relationship of international and domestic law. The tribunals adopted the doctrine of the corrective and supplemental function of international law. At the same time they emphasized that the application of the host State's domestic law was indispensable.

In *Klöckner v. Cameroon*, the Tribunal had based part of the original award on a somewhat broadly defined principle which it sought to base on French law as well as on other national codes. In the proceedings for the annulment of that award (see Module 2.8) 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*

<sup>52</sup> Award, 29 August 1977, 1 ICSID Reports 287.

<sup>53</sup> Award, 21 October 1983, 2 ICSID Reports 63.

*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"*<sup>54</sup>

Subsequent awards also applied the formula of the supplemental and corrective function of international law.

For instance, the second Tribunal in the Resubmitted Case of *Amco v. Indonesia* 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.*<sup>55</sup>

### Superiority of international law

The hierarchy of the sources of law in the context of the second sentence of Article 42 (1) was highlighted in the annulment decision in *Wena Hotels v. Egypt*<sup>56</sup>. The *Ad hoc* Committee sustained the prevalence of the host State's treaties over domestic rules of law and, therefore, held:

*41. In particular, the rules of international law that directly or indirectly relate to the State's consent prevail over domestic rules that might be incompatible with them. In this context it cannot be concluded that the resort to the rules of international law under the Convention, or under particular treaties related to its operation, is antagonistic to that State's national interest.*

The need for ICSID awards to conform with international law also follows from other provisions of the Convention. Art. 54 provides for the enforcement

<sup>54</sup> *Decision on Annulment, 3 May 1985, 2 ICSID Reports 122. 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 Article 42(1).*

<sup>55</sup> *Resubmitted Case: Award, 5 June 1990, 1 ICSID Reports 580.*

<sup>56</sup> *(ICSID Case No. ARB/98/4) Decision on annulment dispatched to the parties on February 5, 2002, unpublished, p. 15.*

of awards in the territory of every Party to the Convention. Art. 27 precludes the exercise of diplomatic protection in respect of claims submitted to ICSID's jurisdiction. Both provisions presuppose that an award would be in compliance with international law.

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

*... 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 obligations imposed by such award enforced, by every Contracting State of the Convention (Article 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 (Article 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.<sup>57</sup>*

### Summary:

- **An ICSID tribunal applying the second sentence of Article 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. In case of conflict, international law prevails.**
- **An ICSID 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.**
- **An ICSID 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.**
- **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.**

<sup>57</sup> *Decision on Annulment, 16 May 1986, 1 ICSID Reports 515.*



## 8. PROHIBITION OF *Non liquet*

### **Prohibition of non liquet**

Article 42(2) establishes:

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

This provision directs that a tribunal may not refuse to render a decision on the ground that the law is not clear. It also prohibits an award that decides certain questions only<sup>58</sup>.

The prohibition of *non liquet* is generally accepted in international adjudication. Similar provisions are adopted by domestic legal systems in order to prevent a denial of justice.

Article 42(2) should be read together with Article 48(3) which states that the award shall deal with every question submitted to the tribunal.

### **Agreement on applicable law. Closing gaps.**

The prohibition to refuse to render a decision applies irrespective of the type of choice of law under the first or second sentence of Article 42(1).

If the parties have agreed on the applicable law, the tribunal must, first, exhaust the possibilities for closing any lacunae within the selected rules of law. The choice of a particular system of law includes whatever gap-filling mechanism the law may establish.

If the chosen law provides no answer to the legal question, the tribunal will resort to the residual rule of Article 42(1), second sentence.

The combination of the host State's law and international law offers such a wide field of authority that a real *non liquet* situation is almost unconceivable.<sup>59</sup>

Perceived gaps in the host State's law may be closed by applying international law's supplementary function.

### **Techniques for filling gaps**

As gap-filling techniques, the tribunal may apply analogy and general principles of law. In addition, judicial decisions, academic writings and codes of conduct may assist the tribunal in the task of closing gaps.

### **Difference between filling gaps and applying equity**

The function of filling *lacunae* is different from the application of equity under Article 42(3). Decisions *ex aequo et bono* require the specific consent of the parties. Failure to apply positive law may constitute an excess of powers and lead to annulment under Article 52(1)(b).

<sup>58</sup> Schreuer, *Commentary*, p. 632.

<sup>59</sup> Schreuer, *Commentary*, p. 632

**Summary:**

- **An ICSID tribunal may not bring a finding of *non liquet*, either by refusing to render an award at all or by avoiding to decide specific questions submitted to the consideration of the tribunal.**
- **In case of an agreement on applicable law, the tribunal must first rely on the selected rules of law. If these yield no answer it must turn to the residual rule of Article 42(1) second sentence and any appropriate technique for the filling of gaps.**
- **The function of filling lacunae differs from the one of applying equity under Article 42(3).**

## 9. DECIDING *ex aequo et bono*

### General meaning

Article 42(3) of the Convention provides:

*(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.*

Therefore, a tribunal, if it is so authorized by the parties, may base its award on extra-legal considerations which it regards as equitable.

In other words, it may disregard the rules of law otherwise applicable under Article 42(1) in favour of justice and fairness.

An agreement to authorize the tribunal to decide *ex aequo et bono* may be particularly appropriate in the case of a complex long-term relationship. As an investment evolves, new circumstances may appear which were not taken into account originally. Thus, a decision based on equity rather than on law may provide a fair solution that takes account of changed circumstances.

### Need of an explicit agreement

The power of the tribunal to decide *ex aequo et bono* requires an agreement by the parties. Such an agreement must be explicit.

### Partial authorization

The authorization given to the tribunal by the parties to decide *ex aequo et bono* may be general or limited to certain issues only. Matters excluded from the authorization must be decided in accordance with rules of law.

### Supervening agreement

While an agreement on decision *ex aequo et bono* will normally be made in advance of the proceedings, this need not be the case. The parties may also agree on decision *ex aequo et bono* in the course of the proceedings.

In *Benvenuti & Bonfant v. Congo*, there was no agreed choice of law and the residual rule of Article 42(1) applied. At the Tribunal's first session, the Claimant suggested that the Tribunal be granted the power to decide *ex aequo et bono*. Although, this initial suggestion was rejected by the Respondent,<sup>60</sup> 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*."<sup>61</sup> After being notified of the failure to settle through negotiations, the Tribunal applied Article 42(3).<sup>62</sup>

### Decision based on equity without parties' consent

An explicit agreement under the terms of Article 42(3) is an absolute prerequisite for a decision based on equity rather than on law. An award deciding

<sup>60</sup> Award, 15 August 1980, 1 ICSID Reports 338.

<sup>61</sup> At p. 342.

<sup>62</sup> At p. 349.



*ex aequo et bono* without the parties' authorization is subject to annulment for excess of powers.

### Application of equity and law

The power provided to a tribunal to decide *ex aequo et bono* does not prevent the tribunal from applying rules of law.

Therefore, the tribunal has discretion not just with regard to the selection of the applicable principles of equity, but also to apply rules of law after all.

In *Benvenuti & Bonfant v. Congo*, the Tribunal was authorized by the parties to decide *ex aequo et bono*. This did not preclude the Tribunal from looking at rules of law<sup>63</sup>. Therefore, it held that compensation in case of nationalization was required by the host State's law, by international law as well as by equity. It determined the quantum of damages *ex aequo et bono*<sup>64</sup>.

### Equity within the law

Not every mention of equitable principles constitutes a decision *ex aequo et bono*. A tribunal may exercise some discretion in applying the law on the basis of justice and fairness. In other words, a decision *ex aequo et bono* must be distinguished from equity within the law.

As the *Ad hoc* Committee acting in *Amco v. Indonesia* stated:

*(not) 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... 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 . . .*<sup>65</sup>.

### Limits on equity

Although the tribunal is empowered by the parties with much discretion to select and apply equitable principles, this discretion is not unlimited. The tribunal may not act arbitrarily. Its decision should be based on objective and rational considerations that must be stated.

The obligation imposed by Article 48(3) that the tribunal must state the reasons underlying an award, extends to decisions *ex aequo et bono*. Failure to state any reasons for a decision *ex aequo et bono* may expose the award to annulment under Article 52(1)(e).

In addition, certain principles of international law which may be summarized as international public policy and *ius cogens* constitute an outer margin for the tribunal's discretion. Even *ex aequo et bono* awards must not violate

<sup>63</sup> *Award*, 15 August 1980, 1 ICSID Reports 350.

<sup>64</sup> *At p.* 357.

<sup>65</sup> *Decision on Annulment*, 16 May 1986, 1 ICSID Reports 516/7.

international public policy principles like the prohibition of slavery or other relevant rules on human rights.

The domestic law of some States does not allow arbitration *ex aequo et bono*. But arbitration under the Convention is truly international and free of any interference of national rules.

#### Summary:

- **The power of the tribunal to decide *ex aequo et bono* is subject to an explicit agreement by the parties.**
- **The parties' agreement can be made in advance of the proceedings or during them.**
- **The power to decide *ex aequo et bono* does not prevent the tribunal from applying rules of law.**
- **The obligation to state the reasons underlying an award extends to decisions *ex aequo et bono*. Absence of such reasons exposes the award to annulment.**



## 10. THE RISK OF ANNULMENT

### Article 52(1)

Article 52(1) of the ICSID Convention provides:

*Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds: [...] (b) that the Tribunal has manifestly exceeded its powers;*

### Failure to apply the proper law as an excess of power

*Ad hoc* Committees have determined that the failure to apply the proper law may constitute an excess of powers and a ground for annulment. Therefore, a negligent application of Article 42 can lead to a decision of nullity.

### Distinction between non application and mistaken application of the proper law

In *Klöckner v. Cameroon*, the *Ad hoc* Committee made the distinction between a failure to apply the proper law and a mere error *in iudicando*. It found that the Tribunal, after having identified the applicable law correctly, 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. In the *Ad hoc* Committee's opinion, the Award's reasoning seemed very much like a reference to equity. Therefore, the Tribunal had not applied the law of the Contracting State but had acted outside the framework of Article 42(1) and had thus manifestly exceeded its powers.<sup>66</sup>

### Summary:

- **Article 52(1) allows either party to request annulment of the award if the tribunal has manifestly exceeded its powers.**
- **A failure to apply the proper substantive law may constitute a manifest excess of powers and end in the award's annulment.**

<sup>66</sup> *Decision on Annulment*, 3 May 1985, 2 ICSID Reports 124 et seq.



## TEST MY UNDERSTANDING

After having studied this Module the reader you should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. What is the relation between autonomy of the parties and applicable law under the ICSID Convention?
2. In what ways can the parties express their agreement to choose a system of law?
3. How must the tribunal select the proper law in the case of absence of agreement?
4. What is the main effect of a stabilization clause?
5. What is the role of international law if the parties have chosen a domestic legal system?
6. What do the terms “such rules of international law as may be applicable” mean in the context of Article 42 of the Convention?
7. Is there any hierarchy between international law and domestic law?
8. Does the ICSID Convention allow a finding of *non liquet*?
9. How should the tribunal deal with a silence or obscurity of the law?
10. Under what circumstances may the tribunal decide *ex aequo et bono*?
11. What is the remedy under the ICSID Convention if the tribunal has failed to apply the proper law?



## HYPOTHETICAL CASES

### *Amplax Corp. v. Republic of Mollovia*

In July 1998, Amplax Corp., a company established under the law of the Republic of Somavek entered into an investment agreement with the Republic of Mollovia. Mollovia and Somavek are both parties to the ICSID Convention. The agreement between Amplax Corp. and Mollovia provides for ICSID arbitration in case of a dispute. It also contains an agreement on the law of the Republic of Mollovia as applicable law. The law of the Republic of Mollovia recognizes the right to expropriate without any compensation. In March 2001, the Republic of Mollovia expropriated Amplax's investment, based on its domestic law. In December 2001, Amplax Corp. instituted ICSID proceedings. There is a BIT between the two States that entered into force in November 1996 which provides for adequate, prompt and effective compensation in case of an expropriation.

Amplax argues that expropriation without compensation is a violation of international law. The Republic of Mollovia bases its defence on the express provision of its domestic legislation and points out that Amplax Corp. agreed to the application of this legislation when the investment agreement was signed.

You are an arbitrator deciding on this matter. Please provide a reasoned decision.

### *Ramslow Inc. v. Gerkland*

In May 1996 Ramslow Inc., a company established under the law of Zaindland, started investing in the State of Gerkland. The investment is governed by an agreement of the same year between Gerkland and Ramslow Inc. providing for dispute settlement under the ICSID Convention. Both Zaindland and Gerkland are parties to the ICSID Convention. The agreement of 1996 also contains a clause on applicable law. This clause provides: "the parties choose exclusively the commercial law of Gerkland to settle any dispute that could arise between them, excluding the application of any provision of international law".

In May 2000, a complex conflict involving administrative, tax and labour aspects, broke out between the Company and the State.

In December 2000, Ramslow Inc. instituted arbitration proceedings before ICSID.

What is the law applicable to the dispute?



Ramslow Inc. alleges that (i) the applicable law clause only covers commercial disputes. Therefore, in accordance with Article 42 of the ICSID Convention, the dispute should be settled under the host State's law as well as international law, and (ii) the waiver to apply international law should be interpreted restrictively, only covering commercial matters.

On the other hand, Gerkland argues that:

- (i) the parties agreed on Gerkland's commercial law to solve any dispute, (ii) the word “exclusively” in the applicable law clause evidences the intention of the parties in choosing Gerkland's domestic law as a whole for all types of disputes, and
- (iii) at all events, the application of international law was expressly excluded by the parties.

Please, try to develop the arguments for either party. Then, try to anticipate the decision of the Tribunal.

## FURTHER READING

### Books

- **Schreuer, C.**, *The ICSID Convention: A Commentary*, (2001).

### Articles

- **Broches, A.**, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 *Recueil des Cours* 331 at 381-395 (1972-II).
- **Broches, A.**, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965, Explanatory Notes and Survey of its Application*, 18 *Yearbook of Commercial Arbitration* 627 (1993).
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