<table>
<thead>
<tr>
<th>Title</th>
<th>Development of Case Law in Investor-State Dispute Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Author(s)</td>
<td>Morita, Kiyotaka</td>
</tr>
<tr>
<td>Citation</td>
<td>Hitotsubashi Journal of Law and Politics, 47: 57-71</td>
</tr>
<tr>
<td>Issue Date</td>
<td>2019-02</td>
</tr>
<tr>
<td>Type</td>
<td>Departmental Bulletin Paper</td>
</tr>
<tr>
<td>Text Version</td>
<td>publisher</td>
</tr>
<tr>
<td>URL</td>
<td><a href="http://doi.org/10.15057/30080">http://doi.org/10.15057/30080</a></td>
</tr>
</tbody>
</table>
DEVELOPMENT OF CASE LAW IN INVESTOR-STATE DISPUTE SETTLEMENT (ISDS)

Kiyotaka Morita*

Introduction

As corporate activities expand globally, the number of disputes between an investing company (hereinafter investor) and a hosting State over foreign direct investment (FDI) has increased significantly in the last 20 years. In 2017, 53 investor-State dispute settlement (hereinafter ISDS) cases were registered to the International Centre for Settlement of Investment Disputes (hereinafter ICSID) for arbitration, while there were only 10 cases registered in 19971. The subject matter of disputes is also diversifying, including unilateral breach of concession agreements, expropriation, arbitrariness of investment permits, unequitable treatment etc.

As of today, the Nissan Motor v. India2, the Bridgestone v. Panama3, the Eurus Energy v. Spain4, the JGC Corporation v. Spain5, and the Saluka v. Czech Republic6 are ISDS cases in which Japanese investors have/had been involved. Since Japan’s economy is heavily dependent on foreign investment, the number of cases that involve Japanese investors as a claimant may increase. Therefore, it is important to study the current developments in case law in this field.

International legal order is based on the principle of pacta sunt servanda, therefore, as stipulated in Article 25 (1) of the ICSID Convention, when the parties have given their consent to ISDS, no party may withdraw its consent unilaterally. Conversely, ISDS would not be possible unless there is consent between the investor and hosting State to arbitrate. The basis of consent to establish ISDS jurisdiction could take the form of an arbitration clause in the concession agreement, a unilateral consent by the hosting State through its domestic investment law, an umbrella clause inserted in bilateral investment treaties (BITs) and economic partnership agreements (EPAs), etc.

This article examines the establishment of ISDS jurisdiction and its relations with the domestic courts of the hosting States (including the necessity of exhausting local remedies), and then analyzes how the ISDS tribunals choose which laws to apply to the disputes under their jurisdiction.

* Senior Manager, Keidanren (Japan Business Federation), Visiting Professor, Hitotsubashi University School of International and Public Policy, LLB (1995), LLM (1997), Hitotsubashi University Faculty of Law.

3 Bridgestone Licensing Services, Inc. and Bridgestone Americas, Inc. v. Republic of Panama, ICSID Case No. ARB/16/34.
5 JGC Corporation v. Kingdom of Spain, ICSID Case No. ARB/15/27.
I. Establishment of ISDS Jurisdiction

1. Basis of Consent

A. Investment Contract

According to ICSID Statistics, 16% of the cases registered under ICSID Convention and Additional Facility Rules base their consent on establishing ISDS jurisdiction on investment contracts. An investor, who is a private person, is an object of international law while a state is a subject of international law. Therefore, the investor is under the complete and exclusive sovereignty of a hosting State and subject to its domestic laws. In other words, the investor is not in a position to submit a claim against a hosting state to be settled in the international sphere, and the State of which the investor is a national may exercise diplomatic protection against the hosting state if the performance of the contract violates the principles of international law.

Why then should the contract between the investor and hosting State have a binding effect to establish ISDS jurisdiction? In the Texaco v. Libya the Sole Arbitrator René-Jean Dupuy notes that by inserting a clause providing that possible differences that may arise in respect of the interpretation and the performance of the contract shall be submitted to arbitration, contracts between States and private persons can come within the ambit of particular and new branches of international law. According to the Sole Arbitrator, legal international capacity is not solely attributable to a State, but also to subjects of a diversified nature. While the States, the original subjects, enjoy all the capacities offered by the international legal order, other subjects (such as investors) also enjoy limited capacities that are assigned to specific purposes. Therefore, for the purposes of interpretation and performance of a contract, a private contracting party has specific international capacities, but unlike a State, the private person has only a limited capacity and his quality as a subject of international law enables him only to invoke, in the field of international law, the rights that he derives from the contract. Thus, by inserting an arbitration clause in a contract between an investor and state, the right to submit a dispute to ISDS derives from the contract, and the investor has specific international capacities that enable him to invoke the right.

B. Investment Law of the Hosting State

Some cases lack an investment contract between an investor and State. For example, in the case of a joint venture contract between a foreign investor and a state-owned enterprise, no legal basis directly binds the hosting State itself. Even in such cases, investor-State arbitration would still be possible if the hosting State unilaterally consents to jurisdiction through its domestic investment law. Actually, 9.2% of the registered ICSID Cases base their jurisdiction on domestic investment law. The Tradex v. Albania is one such case. Tradex (a company
incorporated in Greece) brought the case to ICSID, complaining that acts of expropriation by Albania resulted in dissolution of a joint venture between T.B. Trovitsa (an Albanian state-owned enterprise). Article 8.2 of Albanian Law No. 7764 of November 2, 1993 stipulates that if a dispute arises out of or relates to expropriation, compensation for expropriation, discrimination, and transfers, the foreign investor may submit the dispute to ICSID and the Republic of Albania hereby consents to the submission. The Tribunal, while noting that any claim raised against T.B. Trovitsa relating to obligations arising from the joint venture agreement would be outside its jurisdiction, held that this does not exclude the claim raised by Tradex against Albania, on the basis of Albania’s consent to ICSID Arbitration, alleging that the Respondent itself has performed acts of expropriation against Tradex’s investment.

It should be noted that the unilateral consent must be clear and unambiguous. In the CEMEX v. Venezuela, whether Venezuela consented to ICSID jurisdiction was disputed because the wording under domestic investment law was ambiguous. Article 22 of the 1999 Investment Law provides that disputes to which the provisions of the ICSID Convention are applicable shall be submitted to international arbitration according to the terms of the Convention. The Claimants submitted that Venezuela consented to ICSID jurisdiction under that article, while the Respondent contended that the text does not provide such consent. The ICSID Tribunal denied its jurisdiction. The Tribunal’s decision can be summarized as follows:

i) Unilateral acts by which a State consents to ICSID jurisdiction must be interpreted according to the ICSID Convention and to the principles of international law governing unilateral declarations of States. The relevant words of a declaration are interpreted in a natural and reasonable way, having due regard for the intention of the State concerned, by starting with the text and, if the text is not clear, by giving due consideration to the context and examining the evidence regarding the circumstances of its preparation and the purposes intended to be served.

ii) Article 22 can be interpreted in two ways: the first interpretation is that it refers to international arbitration, while the second interpretation is that it refers to the obligation to submit disputes to international arbitration. Facing an ambiguous and obscure text, the Tribunal cannot base itself on a purely grammatical interpretation of the text and has to look further.

iii) When the Investment Law was enacted in October of 1999, Venezuela was already a party to the ICSID Convention. Therefore, according to the Claimants, it would serve no

---

13 Ibid., pp. 165-168.
14 Ibid., p. 174.
16 Ibid., para. 64.
18 Ibid., para. 65.
19 Ibid., para. 79.
20 Ibid., para. 87.
21 Ibid., paras. 101-103.
purpose to enact a statute unless the intention was to indicate a binding offer of arbitration. In other words, under the doctrine of *l’effet utile*, Article 22 should be interpreted as Venezuela’s binding consent to ICSID arbitration. However, *l’effet utile* does not require that the maximum effect be given to a text, it only excludes interpretations that would render the text meaningless, when a meaningful interpretation is possible. Under the first interpretation, Article 22 has a limited effect while it has far reaching consequences under the second interpretation. But, even under the first interpretation, it has some effect, therefore, even if the principle of *l’effet utile* were applicable, it would be of no use as to the choice to be made between those two interpretations.

iv) At the time of the adoption of the Investment Law, Venezuela had already signed and ratified seventeen BITs stating either that Venezuela gave “its unconditional consent to the submission of disputes” to ICSID arbitration or that its disputes with foreign investors “shall at the request of the national concerned be submitted to ICSID,” or using both phrases. Comparable words were used in some national laws and in the ICSID model clauses. If it had been the intention of Venezuela to give its advance consent to ICSID arbitration in general, it would have been easy for the drafters of Article 22 to express that intention clearly by using any of those formulae.

v) The Tribunal cannot conclude from the obscure and ambiguous text of Article 22 that Venezuela, in adopting the 1999 Investment Law, consented unilaterally to ICSID arbitration for all disputes covered by the ICSID Convention in a general manner.

Similarly, in the *PNG Sustainable Development Program v. Papua New Guinea*, whether the national investment legislation, namely, Section 39 of the Investment Promotion Act (IPA) contains a standing offer to arbitrate under an international instrument was an issue. The ICSID Tribunal also denied its jurisdiction.

i) The provision (Section 39 of the IPA) constitutes a unilateral declaration made by a State, but also produces effects under international law. In this regard, such legislative provisions are of a “hybrid” nature, and as a consequence, interpretation of those provisions must also be approached from a hybrid perspective, taking into account both domestic law and international law. Where the principles of interpretation under the State’s domestic law conflict with international law principles, international law principles will ordinarily prevail.

ii) Nothing in Section 39’s text does more than to declare that the terms of the IDCA (PNG Investment Disputes Convention Act 1978) apply to foreign investments, and the only function of Section 2 of the IDCA is to narrow the category of disputes that may be

23 Ibid., para. 105.
24 Ibid., para. 114.
25 Ibid., para. 115.
26 Ibid., para. 137.
27 Ibid., para. 138.
29 Ibid., para. 264.
30 Ibid., para. 265.
31 Ibid., para. 286.
referred to ICSID\textsuperscript{32}. Likewise, there is nothing else in the IDCA, beyond Section 2, that constitutes consent to ICSID jurisdiction\textsuperscript{33}.

iii) The Claimant argues that the application of l’\textit{effet utile} triggers the actual application of the ICSID Convention to this dispute, in other words, if Section 39 of the IPA does not provide the Respondent’s consent to arbitrate, it serves no meaningful purpose\textsuperscript{34}. However, as l’\textit{effet utile} does not authorize the Tribunal to re-write the legislative provisions\textsuperscript{35}, l’\textit{effet utile} does not provide a basis for finding consent to ICSID jurisdiction in Section 39\textsuperscript{36}. The language of Section 39 of the IPA – even when read in conjunction with Section 2 of the IDCA – is insufficient to establish the Respondent’s “consent in writing” to ICSID jurisdiction\textsuperscript{37}.

C. Bilateral Investment Treaties (BITs)

The ISDS clause inserted in Bilateral Investment Treaties (BITs) including the Investment Chapter of Economic Partnership Agreements (EPAs) also serves as the basis of consent to establish ISDS jurisdiction. For example, Article 82.3 of the Japan-Singapore Economic Partnership Agreement (JSEPA) stipulates that if an investment dispute cannot be settled through consultations within five months, the investor may either (a) request the establishment of an arbitral tribunal, (b) submit the investment dispute to conciliation or arbitration in accordance with the provisions of the ICSID Convention, or (c) submit the investment dispute to arbitration under the Arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL). Thanks to the consent to ISDS jurisdiction between the Parties to the BIT, investors of the Parties can resort to ISDS regardless of whether their investment project has any legal basis directly binding the hosting State. Actually, more than 60\% of the registered ICSID Cases base their jurisdiction on the BITs\textsuperscript{38}.

(1) Disputes Covered by BITs

Arbitral tribunals under the BITs may not cover all types of investor-state disputes. For example, the definition of investment disputes under the Investment Chapter of the Japan-Singapore Economic Partnership Agreement (JSEPA) is “a dispute between a Party and an investor of the other Party that has incurred loss or damage by reason of, or arising out of, an alleged breach of any right conferred by this Chapter with respect to the investments of the investor of that other Party”\textsuperscript{39}. Therefore, in the case of JSEPA, contractual disputes that do not come into conflict with the Investment Chapter of the Agreement might not be subject to arbitration.

ICSID cases also indicate that not all types of investment disputes are subject to arbitration. In the \textit{Salini v. Morocco}\textsuperscript{40}, the scope of a claim to be covered under the arbitration

\textsuperscript{32} Ibid., para. 289.
\textsuperscript{33} Ibid., para. 291.
\textsuperscript{34} Ibid., para. 306.
\textsuperscript{35} Ibid., para. 307.
\textsuperscript{36} Ibid., para. 310.
\textsuperscript{37} Ibid.
\textsuperscript{38} The ICSID Caseload- Statistics (Issue 2018-1), p. 10.
\textsuperscript{39} Article 82.1.
\textsuperscript{40} Salini Costruttori S.P.A and Italstrade S.P.A v. Kingdom of Morocco (Decision on Jurisdiction), ICSID CASE No. ARB/00/4, 23 July, 2001.
clause of the Italy-Morocco Bilateral Treaty (Article 8) was an issue. The Tribunal’s decision was as follows:

i) The terms of Article 8 are very general and cannot be interpreted to exclude a claim based on a contract from the scope of application of this Article.\textsuperscript{41}

ii) Article 8 compels the State to respect the jurisdiction offer in relation to violations of the Bilateral Treaty and any breach of a contract that binds the State directly. The jurisdiction offer contained in Article 8 does not, however, extend to breaches of a contract to which an entity other than the State is a named party.\textsuperscript{42}

iii) This restriction of the Arbitral Tribunal’s jurisdiction only applies to claims that are based solely on a breach of contract. The Arbitral Tribunal retains jurisdiction in relation to breaches of contract that would constitute, at the same time, a violation of the Bilateral Treaty by the State.\textsuperscript{43}

This implies that a breach of contract by an entity other than the State (state-owned enterprises and public agencies for example) that does not accompany a question of incompatibility with the principles of international law (including bilateral treaties) may fall outside the scope of arbitration. Similarly, in the CMS v. Argentina, ICSID held that the standard of protection of the treaty will be engaged only when there is a specific breach of treaty rights and obligations, or a violation of contract rights protected under the treaty, and that purely commercial aspects of a contract might not be protected by the treaty in some situations.\textsuperscript{44}

On the other hand, the Trans-Pacific Partnership (TPP) Article 9.19 stipulates that the claimant may submit to arbitration a claim that the respondent has breached an investment authorisation and/or an investment agreement, in addition to a breach of obligation under the Investment Chapter. Therefore, it could be assumed, whether purely commercial or not, in any such disputes regarding the interpretation of an investor-state contract, damages suffered due to a belated investment permit etc. are subject to arbitration under the TPP.\textsuperscript{45}

(2) Relations between Arbitral Tribunal and Local Courts

Does the arbitral tribunal still have jurisdiction over a dispute when an investment contract refers to submitting disputes to local courts? Would the clause in a contract submitting disputes to local courts be regarded as previous consent between the parties to waiving arbitration?

In the Salini v. Morocco, as described above, a dispute was brought to ICSID under the arbitration clause of the Italy-Morocco Bilateral Treaty. The respondent considered that the claimant is bound by Article 18 of the CCAP (investment contract), which refers to a procedure

\textsuperscript{41} Ibid., para. 59.

\textsuperscript{42} Ibid., para. 61.

\textsuperscript{43} Ibid., para. 62.

\textsuperscript{44} CMS Gas Transmission Company v. The Republic of Argentina (Award), ICSID Case No. ARB/01/8, 12 May, 2005, para. 299.

\textsuperscript{45} However, following the withdrawal of the United States from the TPP, Ministers of 11 TPP Member Countries agreed to suspend the provisions of Article 19.9 related to investment authorisation and/or investment agreement. Thus, for the time being, only claims related to breach of the Investment Chapter of the TPP would be brought to arbitration. (See the Trans-Pacific Partnership Ministerial Statement (November 10, 2017), Annex II- List of Suspended Provisions.).
provided for by the CCAG (administrative law) and gives the administrative courts jurisdiction over disputes arising from the performance of the contract\(^{46}\). On the other hand, the claimant maintained that the consent to ICSID jurisdiction by way of the Bilateral Treaty should prevail over the contractual acceptance of another forum, particularly because the referral to the administrative courts flows from the public nature of the contract, which calls for the mandatory application of the provisions of the CCAG\(^{47}\). In other words, the claimant's position was that contractual acceptance of submitting the matter to the administrative courts was mandatory and could not be regarded as unconstrained consent between the Parties to waive ICSID jurisdiction. ICSID, finding that the CCAG cannot be taken to be truly covered by the principle of the Parties' autonomy\(^{48}\), supported the claimant's position.

Similarly, in the *Lanco v. Argentina*\(^{49}\), an investor-state dispute was brought to ICSID under the arbitration clause of the Argentina-U.S. Treaty; however, the jurisdiction of ICSID was questioned because the Concession Agreement referred to the submission of a dispute to the Federal Contentious-Administrative Tribunals of the City of Buenos Aires. ICSID held that the stipulation of Article 12 of the Concession Agreement, according to which the parties shall submit to the jurisdiction of the administrative tribunals, *cannot* be considered a previously agreed dispute-settlement procedure, because it would hardly be possible to select the jurisdiction of courts whose own jurisdictions are, by law, not subject to agreement or waiver\(^{50}\).

2. Exhaustion of Local Remedies

A. Local Remedies Rule in General

As stated by the ICJ in the *Interhandel Case*, that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law\(^{51}\). In other words, before resorting to an international court, the State where the violation occurred should have an opportunity to redress the situation by its own means, within the framework of its own domestic legal system\(^{52}\). In the *ELSI Case*, the ICJ found it unable to accept that an important principle of customary international law such as the local remedies rule should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so\(^{53}\).

Provided that the local remedies rule is a principle of international law, does an investor need to exhaust the local remedies before bringing a case to ISDS? If an investor enjoys the same legal capacity as a State under international law, the exhaustion of local remedies may be dispensed with because equals have no sovereignty over each other (*par in parem non habet imperium*). It is true, as stated in the *Texaco v. Libya*, that an investor is endowed with legal international capacity\(^{54}\); however, while a State enjoys all the capacities offered by the

\(^{46}\) Supra footnote 40 at para. 25.  
\(^{47}\) Ibid., para. 26.  
\(^{48}\) Ibid., para. 27.  
\(^{49}\) *Lanco International Inc. v. The Argentine Republic (Preliminary Decision: Jurisdiction of the Arbitral Tribunal)*, ICSID CASE No. ARB/97/6, December 8, 1998.  
\(^{50}\) Ibid., para. 26.  
\(^{51}\) *ICJ Reports*, 1959, p. 27.  
\(^{52}\) Ibid.  
\(^{53}\) *ICJ Reports*, 1989, para. 50.
international legal order, an investor has limited capacities that are assigned to specific purposes. Therefore, it could be presumed that having legal international capacity does not necessarily waive an investor from the need to exhaust local remedies.

B. ICSID Cases

The first sentence of Article 26 of the ICSID Convention stipulates that the consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. This sentence is interpreted to secure the exclusivity of a reference to ICSID arbitration vis-à-vis any other remedy, and a logical consequence of this exclusivity is the waiver by Contracting States to the ICSID Convention of the local remedies rule, so that the investor is not compelled to pursue remedies in the respondent State’s domestic courts.

On the other hand, the second sentence of Article 26 stipulates that a Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention. Therefore, it is possible for a hosting State to require the exhaustion of domestic remedies as a prior condition for its consent to ICSID arbitration in BIT, domestic legislation, or an investment agreement. However, even if the exhaustion of local remedies is required under the BIT, investors can still avoid the application of such a rule by invoking the most favored nation (MFN) clauses in the same BIT, which allows them to rely on other BITs of the hosting State that did not contain the requirement. In the Maffezini v. Spain, Maffezini, a national of Argentina requested arbitration regarding his investment in Spain by having recourse to the Argentine-Spain BIT. Since the claimant failed to submit the instant case to Spanish courts as required by the BIT, ICSID initially found that it lacked jurisdiction. However, by invoking the most favored nation clause included in the Argentine-Spain BIT and relying on the Chile-Spain BIT, which did not require the exhaustion of local remedies, the claimant was ultimately able to submit the instant dispute to ICSID arbitration without first accessing the Spanish courts.

C. Non-ICSID Cases

As stated above, in the case of ICSID arbitration, unless expressly required, the local remedies requirement cannot be implied in BITs due to Article 26 of the Convention. Non-ICSID tribunals have also dispensed with the local remedies when BITs are silent on the requirement.

In the Yaung Chi Oo v. Myanmar, a case under the 1987 Agreement for the Promotion and Protection of Investments of the Association of Southeast Asian Nations (ASEAN), the respondent objected to the tribunal’s jurisdiction, arguing that the claimant had failed to exhaust local remedies. The tribunal dismissed the objection on the grounds that the case was not brought under the domestic law of Myanmar and did not require espousal by the claimant’s home state, and that the 1987 agreement did not contain the local remedies requirement.

---

54 Supra footnote 8 at para. 47.
55 Ibid.
56 Generation Ukraine, Inc. v. Ukraine, ICSID Case No. ARB/00/9 (September 16, 2003), para. 13.4.
57 Lanco. v. Argentina, supra footnote 49, para. 39.
58 Emilio Augustín Maffezini v. The Kingdom of Spain, Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (January 25, 2000), paras. 36-37.
59 Ibid., para. 64.
In the UNCITRAL case CME v. Czech Republic, the Respondent’s Counsel stated, with a view to taking due account of the Czech court’s decisions on matters of Czech law, that the tribunal should await the final decision of pending proceedings in the Czech court. However, the tribunal’s decision was that doing so would amount to injecting into the applicable BIT a local remedies requirement, on which the BIT was silent. It further rejected the requirement by expressing that arbitration under a BIT would involve a high risk, always being threatened by the Damocles’ sword of annulment on the basis that local remedies had not been exhausted.

In the ELSI Case, as described above, the ICJ held that the local remedies rule should not be dispensed with in the absence of a clear intention to do so (required unless waived). On the contrary, arbitral tribunals have established the understanding that the reversal of the local remedies rule (waived unless required) applies to non-ICSID arbitration as well. Presumably this is because non-ICSID arbitral tribunals regard, as aptly pointed out in the Mytilineos v. Serbia and Montenegro, the fact that BITs granting private investors direct access to international arbitration itself waives the local remedies requirement, since including such a requirement would seriously undermine the effectiveness of arbitration.

Once again, as stated in the Texaco v. Libya, the legal international capacity of an investor is limited, enabling him only to invoke the rights which he derives from the contract. This means an investor could do away with the local remedies rule provided that such a right to do so derives from the investment contract. In other words, if a clause that aims at exempting the application of the local remedies rule is inserted in the investment contract, exhaustion of the rule would not be necessary.

Here, whether an explicit clause exempting the application of the local remedies rule is mandatory, or insertion of an arbitration clause would suffice to do away with the rule is questionable. For example, Mann, in his article in the 1960s, seems to have taken the former view. According to him, the arbitration clause as such does not imply a waiver of the local remedies rule, because provided that the courts of the respondent State can undo the wrong suffered by the alien, it is in the interests of the peaceful settlement of disputes between States to have this done before international litigation is started. However, by corollary of the recent BIT cases waiving the local remedies rule unless required as indicated above, the latter view might be more persuasive today.

---

60 Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar, ASEAN I.D. Case No. ARB/01/1 (March 31, 2003), Award, paras. 40-41.
62 CME Czech Republic B.V. v. The Czech Republic, UNCITRAL, Final Award (March 14, 2003), para. 412.
63 Ibid., para. 413.
64 Supra footnote 53.
65 Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia, UNCITRAL, Partial Award on Jurisdiction (September 8, 2006), para. 222.
66 Supra, footnote 8 at para. 47.
II. Choice of Applicable Law

Foreign investment is subject to the domestic legislation of the hosting State. Therefore, whether the principles of international law could offer any remedy in the face of a regulatory change by a hosting State is a matter of great concern for investors. In the interim, whether domestic legislation has any function when the principles of international law are designated as an applicable law needs to be examined as well.

Regarding the choice of applicable law under the ICSID Convention, there are two steps. The first sentence of Article 42 (1) of the ICSID Convention stipulates that the Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. Then, the second sentence of the same Article stipulates that 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.

1. The Role of International Law in Applying Domestic Laws

A. ICSID Convention Article 42 (1), First Sentence

As for the first sentence of Article 42 (1), would rules of international law have any role to play if the parties agreed on applying the domestic laws of the hosting State?

In the SPP (Middle East) v. Egypt, ICSID held that even if the Parties have implicitly agreed to apply Egyptian law, such an agreement cannot entirely exclude the direct applicability of international law in certain situations. According to ICSID, when municipal law contains a lacunae, 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.

In this incident, the Respondent argued that the cancellation of the disputed project was not a “nationalization” or “confiscation” prohibited by Law No. 43 of 1974. The Respondent further contended that under Egyptian law, expropriation does not apply to contractual and other incorporeal rights, but only to real property rights, therefore, those interests of the Claimants that were affected by the cancellation of the project were not the kind of interest that is susceptible of expropriation under Egyptian law.

However, the Tribunal rejected the Respondent’s contention by citing cases of international courts that upheld that expropriation may extend to a wide range of rights including intangible rights such as contractual rights. Eventually the Tribunal ruled that the duty to compensate in

---

68 Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt, Case No. ARB/96/1, Tribunal Award of 20 May, 1992, para. 80.
69 Ibid., para. 84. Here, the Tribunal refers to the explanation by one of the authors of the Washington Convention that such a process “will not involve the confirmation or denial of the validity of the host State's law, but may result in not applying it where that law, or action taken under that law, violates international law.” (A. Broches, “The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States,” Recueil des Cours, Vol. 136, p. 342 (1972).).
70 Ibid., para. 160.
71 The Tribunal refers to: the Certain German Interests in Polish Upper Silesia, in which the Permanent Court of International Justice ruled
the event of expropriation cannot be evaded by contending that municipal regulations give a narrow meaning to the term “expropriation” or apply the concept only to certain kinds of property.

B. ICSID Convention Article 42 (1), Second Sentence

As for the second sentence of Article 42 (1), in what manner would the domestic law of the hosting State and rules of international law be applied?

In the Klöckner v. Cameroon (Decision on Annulment), the ICSID Annulment Committee held that 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 and after having applied the relevant rules of the State’s law. At the same time, according to the Decision, Article 42 gives these principles a corrective role, should the State’s law not conform on all points to the principles of international law. That is to say, although the domestic law of the hosting State would apply in the first place, it must be applied in conformity with the rules of international law, and should a conflict between the two occur, the latter would prevail.

The ICSID Tribunal held a similar view in the Wena Hotels v. Egypt. The case was brought to ICSID under the UK-Egypt Investment Promotion and Protection Agreement (IPPA). However, the IPPA was a fairly terse agreement of only seven pages containing thirteen articles, therefore, the parties as well as the Tribunal have not treated it as containing all the rules of law applicable to their dispute. Having found that there was no special agreement between the parties on the rules of law applicable beyond the IPPA, the Tribunal decided to apply both Egyptian law and such rules of international law as may be applicable according to Article 42(1) of the ICSID Convention.

In the proceedings, the Respondent, having recourse to Article 172 (i) of the Egyptian Civil Code, which stipulates a three-year statute of limitation, contended that Wena’s claims were time barred. However, the Tribunal rejected this contention from the viewpoint of ensuring the precedence of international law norms where the rules of the applicable domestic law are in conflict with such norms. The Tribunal upheld that strict application of Article 172 (i)’s three-year limit, would collide with the general, well-established international principle that municipal statutes of limitation do not bind claims before an international tribunal.

Unpersuaded by the Award, Egypt argued, in the Annulment Proceedings, that the

---

72 Ibid., para. 168.
73 Klöckner Industrie-Anlagen GmbH v. Republic of Cameroon, Case No. ARB/81/2, Decision on Annulment of 3 May, 1985, para. 69.
74 Ibid.
75 Wena Hotels Ltd. v. Arab Republic of Egypt, Case No. ARB/98/4, Award of 8 December, 2000, para. 79.
76 Ibid.
77 Ibid., para. 107.
78 Ibid.
Tribunal failed to apply Egyptian law in contravention of Article 42(1) of the Convention. The ICSID Annulment Committee rejected this argument by pointing out that the use of the word “may” in the second sentence of this provision 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. The Committee further stated that the law of the hosting State could be applied in conjunction with international law, while international law could be applied by itself if the appropriate rule is found.

2. The Role of Domestic Laws in Applying International Law

In cases in which the parties agreed to apply BITs, multilateral treaties or rules of international law, domestic laws of the hosting country still have an important role. As the Permanent Court of International Justice (PCIJ) pointed out in the Polish Upper Silesia Case, from the standpoint of international law, municipal laws are merely facts which express the will and constitute the activities of States. Therefore, the Court is not called upon to interpret municipal law as such; but there is nothing to prevent the Court giving judgment on the question of whether or not, in applying the municipal law, the State is acting in conformity with its obligations under international law.

A. Siemens v. Argentina

In the Siemens v. Argentina, the ICSID Tribunal held that while the Tribunal’s inquiry is governed by the Treaty (Argentina-Germany BIT) and by applicable international law, Argentina’s domestic law constitutes evidence of the measures taken by Argentina and of Argentina’s conduct in relation to its commitments under the Treaty. In this case, the Treaty required that the expropriation be for a public purpose. In deciding whether Argentina acted in conformity with the Treaty, the Tribunal examined municipal legislation, namely the 2000 Emergency Law and Decree 669/01. The Tribunal admitted that the public purpose of the 2000 Emergency Law to face the dire fiscal situation of the Government was a legitimate concern of Argentina. On the other hand, it found that application of the 2000 Emergency Law through Decree 669/01 to the specific case of Siemens’ investment was questionable because Decree 669/01 served as a convenient device to continue the expropriation process that started more than a year earlier than the onset of the fiscal crisis.

Thus, the Tribunal did not interpret the 2000 Emergency Law nor Decree 669/01 as such, while finding that Argentina applied municipal legislation for the sake of justifying the continuation of the expropriation process. Based on this evidence, the Tribunal came to the

80 Ibid., para. 39.
81 Ibid., para. 40.
82 PCIJ Series A, No.7, p.19.
83 Ibid.
85 Ibid., para. 78.
86 Ibid., para. 273.
87 Ibid.
conclusion that the Respondent acted incompatibly with the “public purpose” required under the Argentina-Germany BIT.

B. **Gold Reserve Inc. v. Venezuela**

Also, in the *Gold Reserve Inc. v. Venezuela*\(^{88}\), the governing law was the Canada-Venezuela BIT and international law, supplemented by such rules of public international law that shall be applicable\(^{89}\). Nevertheless, the ICSID Tribunal regarded the role of Venezuelan law important because it informs the content of the Claimant’s rights and obligations within the legal framework established by the relevant municipal legislation, as well as the content of commitments made by the Respondent to the Claimant\(^{90}\).

In this case, the Respondent revoked the Claimant’s investment project by having recourse to the Emergency Decree. However, the Emergency Decree referred to in the Revocation Order was already in force when the Construction Permit was issued on 27 March, 2007. Therefore, the Tribunal assumed that Min Amb (Ministry of Environment) had verified, prior to issuing the Construction Permit, that the works to be authorized did not conflict with the objective of the Emergency Decree\(^{91}\). In addition, the Emergency Decree expired on 26 June, 2007 and there was no warning by Min Amb that the situation regarding the environment had significantly deteriorated since the date on which the Construction Permit was issued\(^{92}\). Having considered the above application of municipal legislation, the Tribunal found that the Respondent's conduct did not accord with the obligations required by the fair and equitable treatment (FET) standard in the BIT\(^{93}\).

Here again, the Tribunal did not interpret the Emergency Decree nor the Construction Permit as such. The Tribunal found that Venezuela was not in conformity with the FET standard in the BIT because the Emergency Decree was applied in a manner unreasonably denying the Claimant’s rights under the Construction Permit.

C. **Masdar Solar & Wind v. Spain**

The *Masdar Solar & Wind v. Spain*\(^{94}\) was arbitrated by the ICSID Tribunal under Article 26 (6) of the Energy Charter Treaty (ECT), which stipulates that a tribunal shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law. In this case, whether specific commitments under Spanish domestic legislation (RD661/2007 and other texts) offering incentives to renewable energy plants gave rise to legitimate expectations of the Claimant; and whether the domestic legislation was modified in a manner incompatible with the fair and equitable treatment (FET) standard of the ECT was an issue. The judgment of the Tribunal could be summarized as follows:

i) The FET constitutes a standard to ensure that an investor may be confident that the legal framework in which the investment has been made will not be subject to unreasonable or unjustified modification; and the legal framework will not be subject to modification in a

---

\(^{88}\) *Gold Reserve Inc. v. Bolivian Republic of Venezuela*, Case No. ARB(AF)/09/1, Award of 22 September, 2014.

\(^{89}\) *Ibid.*, para. 534.

\(^{90}\) *Ibid.*.

\(^{91}\) *Ibid.*, para. 596.

\(^{92}\) *Ibid.*.

\(^{93}\) *Ibid.*, para. 600.

\(^{94}\) *Masdar Solar & Wind Coopertatief U.A. v. Kingdom of Spain*, Case No. ARB/14/1, Award of 16 May, 2018.
manner contrary to specific commitments made to the investor⁹⁵.

ii) The RD661/2007 regime held out the prospect that provided an installation complied with certain registration requirements and within the prescribed time limits, it would acquire the right to receive the regulated tariff or premium⁹⁶. In the interim, the Claimant, on the basis of due diligence exercised, believed that it had a legitimate expectation that the laws would not be modified, as they included stabilization clauses⁹⁷.

iii) The fact that RD661/2007 and other texts include a stabilization clause is sufficient to exclude any modification of the law, as far as investors which had made investments in reliance upon its terms were concerned⁹⁸.

iv) There is a school of thought that considers that a specific commitment giving rise to legitimate expectations cannot result from general provisions and that something more is needed⁹⁹. However, in this case, Spain has issued a Resolution addressed to each Operating Company confirming that the Plants are qualified under the RD661/2007 regime for their operational lifetime¹⁰⁰. Because of the Resolution, the Claimant had legitimate expectations that the benefits granted by RD661/2007 would remain unaltered irrespective of whether general provision would be sufficient¹⁰¹.

v) By reason of the loss of the RD661/2007 regime and the rights accrued by the Claimant, the respondent is in breach of the FET obligations pursuant to Article 10 (1) of the ECT¹⁰².

Much like the above cases, the Tribunal did not interpret RD661/2007 and other texts as such. It regarded the domestic legislation as evidence that gave rise to the Claimant’s rights (legitimate expectations). Having found that modification of the domestic legislation in this case infringed on the Claimant’s legitimate expectations, the Tribunal concluded that the Respondent was not in conformity with the FET standard of the ECT.

III. Conclusion

The European Commission is concerned that the ISDS rules may be abused to prevent hosting States from making legitimate policy choices¹⁰³. However, this does not seem to be the case.

As seen above, should the ISDS tribunal have jurisdiction, there must be a legal basis of consent between the investor and hosting State, namely, contract, domestic investment law, BITs including the Investment Chapter of EPAs or multilateral agreement such as the ECT. Therefore, an investor cannot bring a case just because his/her profits have been reduced

---

⁹⁵ Ibid., para. 484.
⁹⁶ Ibid., para. 496.
⁹⁷ Ibid., para. 499.
⁹⁸ Ibid., para. 503.
⁹⁹ Ibid., para. 504.
¹⁰⁰ Ibid., para. 520.
¹⁰¹ Ibid., para. 521.
¹⁰² Ibid., para. 522.
following a regulatory change by a hosting State. A case can be brought to ISDS only when an investor is able to demonstrate that one of the provisions inserted in such legal basis of consent (e.g. FET) has been breached. Those provisions do not interfere with the legitimate policy per se, but only prohibit the hosting State from pursuing its legitimate policy in a manner incompatible with them. As seen in the above cases, the Tribunal is not banning domestic legislation as such, but finding it incompatible with those provisions as applied. The hosting State is at liberty to pursue its legitimate policy as long as it does not run contrary to those provisions.