

Failure to Apply the Governing Law in International Investment Arbitration

Christoph Schreuer*

I. The Law Applicable in Investment Arbitration

A. Introduction

Activities by foreign investors are invariably affected by the host State's domestic law. The relevant legislation will concern commercial law, company law, administrative law, labour law, tax law, foreign exchange regulations, real estate law and many other areas of the host State's legal system. At the same time, the foreign investor is typically protected by international law, most often in the form of bilateral investment treaties (BITs) and other treaties, but also in the form of customary international law.

When a dispute arises, the investor will tend to rely on the international safeguards. The host State will often insist on compliance with its domestic law. A decision in accordance with the applicable law is one of the central duties of a tribunal deciding an investment dispute. Whether the choice of law is made through a treaty provision, in an agreement between the parties or both, the outcome of the case is likely to be determined by that choice. Therefore, a failure to apply the governing law is a serious violation of the tribunal's parameters for decision.

This article considers the means by which arbitral tribunals decide which law to apply to investment disputes, the means by which these decisions may be reviewed, and the consequences of failing to apply the law that properly governs the dispute. Over the last twenty years a number of attempts have been made to challenge arbitral awards in investment disputes on the ground that they were not based on the applicable law. ICSID *ad hoc* committees as well as domestic courts have dealt with these challenges in widely differing decisions.

* Dr. iur. (Vienna), LL.M. (Cantab.), JSD (Yale), Professor of International Law, Department of International Law and International Relations, University of Vienna. The author wishes to express his gratitude to Professor Janet Walker of Osgoode Hall Law School of York University, Toronto for valuable comments on a draft of this article.

B. General Provisions for Determining the Applicable Law

Choice of law clauses may be contained in relevant treaty provisions. They may also be agreed as between the parties to the dispute, that is the host State and the investor. In fact, some treaty provisions refer to the parties' agreement on choice of law. In turn, treaty provisions on the applicable law may form the basis of an agreement between the parties.

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

Article 1131
Governing Law

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

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

Article 26
Settlement of Disputes between an Investor and a Contracting Party

[...]

(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.²

By contrast, the ICSID Convention defers to any agreement on choice of law made by the parties. In the absence of such an agreement, it provides for the application of the host State's law and international law:

Article 42

(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.³

¹ 32 *ILM* 605, at 645 (1993).

² 34 *ILM* 360, at 400 (1995).

³ 4 *ILM* 532, at 539 (1965), available at <http://www.worldbank.org/icsid/basicdoc/22.htm>.

The ICSID Additional Facility Arbitration Rules do not specify the applicable law, in the absence of an agreement by the parties, but merely prescribes a method for ascertaining it:

Article 54

(1) The Tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the Tribunal shall apply (a) the law determined by the conflict of laws rules which it considers applicable and (b) such rules of international law as the Tribunal considers applicable.⁴

The UNCITRAL Arbitration Rules were not drafted primarily with a view to investor/State arbitration, but they are frequently used in investment disputes. They refer to party agreement on applicable law and to applicable conflict of law rules:

Article 33

1. The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.⁵

C. Choice of Law by the Parties

Agreements between the parties on applicable law show considerable variety. Some simply refer to the host State's domestic law.⁶ The choice of the law of the investor's home country or of the law of a third State is rare, but it sometimes occurs in the context of loan contracts.⁷

The majority of agreements dealing with investor/State arbitration contain choice of law clauses that include the domestic law of the host State as well as international law. These compound choice of law clauses combining domestic and international law have much to commend them. Most investments are complex operations involving

⁴ ICSID/11/Rev. 1 January 2003. The Rules were amended as per 1 January 2003. The numbering follows the amended version.

⁵ Available at <http://www.uncitral.org/en-index.htm>.

⁶ See, e.g., *Attorney-General v. Mobil Oil NZ Ltd.*, New Zealand, High Court, 1 July 1987, 4 *ICSID Reports* 123. See also *MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 *ICSID Reports* 94. In that case the applicable law was the law of Guinea subject to the agreement of the parties.

⁷ See, e.g., *SPP v. Egypt*, Award, 20 May 1992, 3 *ICSID Reports* 242. The choice of English law to the exclusion of Egyptian law turned out to be decisive for the computation of interest.

numerous transactions of different kinds. In the vast majority of instances these transactions will be closely linked to the local law. In terms of the conflict of laws, the transaction will have its closest connection to the host State's legal system. At the same time, the application of international law gives the investor assurance that international minimum standards will apply in the event that local law should fall below them.

Compound clauses on applicable law are not a recent innovation. Clauses of this kind can be found in early investor/State agreements. For instance, Deeds of Concession concluded between Libya and two American companies between 1955 and 1968 contained a provision on arbitration part of which was the following choice of law clause:

(7) This Concession shall be governed by and interpreted in accordance with the principles of law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.⁸

In cases involving contractual clauses that referred to domestic law as well as to international law, arbitral tribunals were careful to examine both the host State's domestic law and international law.⁹ The same practice was followed by tribunals applying the residual rule of Article 42(1) of the ICSID Convention, which provides for the application of host State law and applicable rules of international law.¹⁰

⁸ *Texaco v. Libya*, Award, 19 January 1977, 53 *ILR* 389, at 404. The Tribunal proceeded to analyse and apply the domestic law of Libya, in addition to international law in some detail. See also *LIAMCO v. Libya*, Award, 12 April 1977, 62 *ILR* 140, at 172; *British Petroleum v. Libya*, 10 October 1973, 53 *ILR* 297; *AGIP v. Congo*, Award, 30 November 1979, 1 *ICSID Reports* 313; *Kaiser Bauxite v. Jamaica*, Decision on Jurisdiction, 6 July 1975, 1 *ICSID Reports* 301.

⁹ *AGIP v. Congo*, Award, 30 November 1979, 1 *ICSID Reports*, at 322-324.

¹⁰ *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, 1 *ICSID Reports* 349; *SOABI v. Senegal*, Award, 25 February 1988, 2 *ICSID Reports*, at 221 *et seq.*, 229, 249 *et seq.*, 257; *LETCO v. Liberia*, Award, 31 March 1986, 2 *ICSID Reports*, at 358-359, 372; *SPP v. Egypt*, Award, 20 May 1992, 3 *ICSID Reports* 189, at 207-209, 225-228, 234-235, 242-244; *Cable TV v. The Federation of St. Christopher (St. Kitts) and Nevis*, Award, 16 December 1996, 13 *ICSID Review—FILJ* 328, at 371; *CDSE (Santa Elena) v. Costa Rica*, Award, 17 February 2000, 15 *ICSID Review—FILJ* 191 (2000). For an extensive discussion of this provision See C. Schreuer, *The ICSID Convention: A Commentary* 595-631 (2001).

D. BIT Provisions on Applicable Law

In recent years most investment arbitrations are conducted under the terms of bilateral investment treaties (BITs). Most BITs provide for investor/State arbitration. Some contain provisions on applicable law.¹¹

In the case of investor/State arbitration based on BITs, consent to arbitration is also the result of an agreement between the disputing parties, i.e. the host State and the foreign investor. The clause on dispute settlement in the BIT constitutes a standing offer by the two countries to investors from the other country. The arbitration agreement is concluded by the acceptance of this offer by the investor. This acceptance may be demonstrated by the institution of arbitral proceedings. This way of reaching an arbitration agreement between a host State and a foreign investor is accepted by international arbitral practice.¹²

The offer to arbitrate contained in a BIT may be subject to conditions and specifications. By taking up the offer of arbitration, the investor accepts the choice of law clause contained in the BIT's dispute settlement provision. Therefore, the treaty's provision on applicable law becomes part of the arbitration agreement. The clause on applicable law becomes a choice of law agreed by the parties to the arbitration.¹³

Provisions in BITs dealing with applicable law typically combine the host State's domestic law and international law. The most frequent formula lists a) the host State's law, b) the BIT itself together with other treaties, c) any contract relating to the investment and d) general international law.

¹¹ A. R. Parra, "Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment", 12 *ICSID Review—FILJ* 287, at 332 (1997); P. Peters, "Dispute Settlement Arrangements in Investment Treaties", 22 *Netherlands Yearbook of International Law* 91, at 147 *et seq.* (1991).

¹² See, e.g., *AAPL v. Sri Lanka*, Award, 27 June 1990, 4 *ICSID Reports* 251; *AMT v. Zaire*, Award, 21 February 1997, 36 *ILM* 1531, at 1545-1546 (1997); *Fedax v. Venezuela*, Decision on Jurisdiction, 11 June 1997, 37 *ILM* 1378, at 1384 (1998); *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, 14 *ICSID Review—FILJ* 251, at 264 (1999); *LANCO v. Argentina*, Decision on Jurisdiction, 8 December 1998, 40 *ILM* 457, at 460, 468, 471; *Maffezini v. Spain*, Decision on Jurisdiction, 25 January 2000, 16 *ICSID Review—FILJ* 212 (2001); *Antoine Goetz v. Burundi*, Award, 10 February 1999, 15 *ICSID Review—FILJ* 454 (2000).

¹³ See Parra, *supra* note 11; see also Peters, *supra* note 11; I. F. I. Shihata/A. R. Parra, "The Experience of the International Centre for Settlement of Investment Disputes", 14 *ICSID Review—FILJ* 299, at 336 (1999).

An example of such a provision may be found in Article 10 of the Argentina/Netherlands BIT of 1992:

7. The arbitration tribunal addressed in accordance with paragraph (5) of this Article shall decide on the basis of the law of the Contracting Party which is a party to the dispute (including its rules on the conflict of laws), the provisions of the present Agreement, special Agreements concluded in relation to the investment concerned as well as such rules of international law as may be applicable.¹⁴

Tribunals applying clauses on applicable law based on BITs have emphasized that they were bound to apply both the law of the host State and international law.

In *Fedax v. Venezuela*, jurisdiction was based on the Netherlands/Venezuela BIT of 1991. The Netherlands/Venezuela BIT contains the following provision on applicable law to investor/State disputes in its Article 9(5):

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

The Tribunal said:

30. Besides the provisions of the [ICSID] Convention and the Agreement [i.e. the BIT], the Tribunal finds that Venezuelan law is also relevant as the applicable law in this case. In fact, the promissory notes subject matter of the dispute are in turn governed by the provisions of the Venezuelan Commercial Code and more specifically by those of the Law on Public Credit, having been issued under the terms of the latter. Both parties have pointed in their pleadings to relevant aspects of the Venezuelan legislation and the Tribunal has examined these provisions with particular attention. It is of interest to note in this respect that the various sources of the applicable law referred to in Article 9(5) of the Agreement [i.e. the BIT], including the laws of the Contracting Party, the Agreement, other special

¹⁴ Argentina/Netherlands BIT, 20 October 1992. Similar provisions on applicable law were applied in *Fedax v. Venezuela*, Award, 9 March 1998, 37 *ILM* 1391, at 1396 (1998), *Maffezini v. Spain*, Decision on Jurisdiction, 25 January 2000, 16 *ICSID Review—FILJ* 207, at 219 (2001) and *Antoine Goetz v. Burundi*, Award, 10 February 1999, 15 *ICSID Review—FILJ* 454, at 499 (2000), available at <http://www.worldbank.org/icsid/cases/goetz.pdf>.

agreements connected with the investment and the general principles of international law, have all had an important and supplementary role in the consideration of this case as well as in providing the basis for the decision on jurisdiction and the award on the merits. This broad framework of the applicable law further confirms the trends discernible in ICSID practice and decisions.¹⁵

This award confirms that the law of the host State is part of the law to be applied where the applicable law is governed by a choice of law clause in a BIT that includes a reference to host State law.

In *Maffezini v. Spain*, jurisdiction was based on the BIT between Argentina and Spain of 1991. That BIT contains the following provision on applicable law to investor/State disputes in its Article 10(5):

5. The Arbitral Tribunal shall decide the dispute in accordance with the provisions of this Agreement, the terms of other Agreements concluded between the parties, the law of the Contracting Party in whose territory the investment was made, including its rules on conflict of laws, and general principles of international law.¹⁶

The Tribunal did not embark upon a theoretical discussion on the law applicable to the dispute but did, in fact, apply Spanish law. It referred to and applied the Spanish Law on Public Administration and Common Administrative Procedure,¹⁷ the Spanish Constitution,¹⁸ environmental legislation, including an EEC Directive,¹⁹ the Spanish Civil Code as well as the Spanish Commercial Code together with authoritative commentaries.²⁰ With respect to one of the claims the Tribunal concluded:

71. The Kingdom of Spain and SODIGA [a State entity] have done no more in this respect than insist on the strict observance of the EEC and Spanish law applicable to the industry in question. It follows that Spain cannot be held responsible for the decisions taken by the Claimant with regard to the EIA [Environmental Impact Assessment]. Furthermore, the Kingdom of Spain's

¹⁵ *Fedax v. Venezuela*, Award, 9 March 1998, 37 *ILM* 1391, at 1396 (1998). Footnotes omitted.

¹⁶ *Maffezini v. Spain*, Decision on Jurisdiction, 25 January 2000, 16 *ICSID Review—FILJ* 219 (2001), available at http://www.worldbank.org/icsid/casesemilio_DecisiononJurisdiction.pdf.

¹⁷ *Maffezini v. Spain*, Award, 13 November 2000, at paras. 47-49, 92, available at http://www.worldbank.org/icsid/cases/emilio_AwardoftheTribunal.pdf.

¹⁸ *Ibid.*, at para. 68.

¹⁹ *Ibid.*, at paras. 68, 69.

²⁰ *Ibid.*, at paras. 82, 89, 90.

action is fully consistent with Article 2(1) of the Argentine-Spain Bilateral Investment Treaty, which calls for the promotion of investment in compliance with national legislation. The Tribunal accordingly also dismisses this contention by the Claimant.²¹

It follows that a tribunal, acting under a BIT that contains a choice of law clause referring to host State law and international law, must apply the domestic law of the host State.

The clearest analysis of a clause on applicable law in a BIT was made by the Tribunal in *Antoine Goetz v. Burundi*.²² In that case the relevant BIT between the Belgium-Luxemburg Economic Union and Burundi contained the following provision on applicable law:

The arbitral body decides on the basis of:

- the domestic law of the contracting party to the dispute, on the territory of which the investment is located, including its rules relating to the conflict of laws;
- the provisions of the present Treaty
- the terms of the particular agreement which might have taken place regarding the investment;
- the generally accepted rules and principles of international law.

The Tribunal confirmed that a choice of law clause contained in a provision of a BIT, dealing with investor/State disputes, constituted an agreement on applicable law between the parties to the dispute. This was a consequence of the host State's offer contained in the BIT and the investor's acceptance of that offer expressed through the institution of the proceedings:

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

²¹ *Ibid.*, at para. 71.

²² *Antoine Goetz v. Burundi*, Award, 10 February 1999, 15 *ICSID Review—FILJ* 454 (2000), available at <http://www.worldbank.org/icsid/cases/goetz.pdf>.

distinct agreement between the host State and the investor, it is one of the first times, it seems, that an ICSID Tribunal is called to apply the law as directly determined by such a treaty.²³

On the basis of the BIT's choice of law clause, the Tribunal reached the conclusion that the applicable legal rules were a combination of domestic and international law. The four categories of sources listed in the BIT could be regrouped into two: the law of Burundi on one hand and international law on the other. The provisions of the BIT were part of the applicable rules and principles of international law.²⁴ After summarizing the opinions on the relationship between domestic law and international law under the second part of Article 42(1) of the ICSID Convention, the Tribunal turned to the applicable law in the case before it:

In the present case—which relates, it must be recalled, to the first sentence of Article 42 of the ICSID Convention—a complementary relationship must be allowed to prevail. That the Tribunal must apply Burundian law is beyond doubt, since this last is also cited in the first place by the relevant provision of the Belgium-Burundi investment treaty. As regards international law, its application is obligatory for two reasons. First, because, according to the indications furnished to the Tribunal by the claimants, Burundian law seems to incorporate international law and thus to render it directly applicable; ... Furthermore, because the Republic of Burundi is bound by the international law obligations which it freely assumed under the Treaty for the protection of investments, ...²⁵

The Tribunal's analysis of the merits of the case followed a two-pronged approach. First, it undertook a detailed analysis of the problem from the perspective of the law of Burundi. This analysis led to the conclusion that under the law of Burundi the actions in question were not illegal and, consequently, the State had not incurred responsibility. Having reached this result, the Tribunal then examined the same issue from the perspective of international law, in particular in light of the BIT. This examination led to the result that the Republic of Burundi was under an obligation to pay compensation to the Claimant.

E. The Relationship of Domestic Law and International Law

Some BITs contain specific rules concerning the relationship of domestic law and international law. These typically state that the provisions most favourable to the investor shall prevail. An example may be found in Article 3(5) of the BIT between

²³ *Ibid.*, at para. 94. Footnote omitted.

²⁴ *Ibid.*, at para. 96.

²⁵ *Ibid.*, at para. 98.

the Netherlands and the Czech Republic:

If the provisions of law of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Parties in addition to the present Agreement contain rules, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by the present Agreement, such rules shall to the extent that they are more favourable prevail over the present Agreement.

But in many cases tribunals do not receive guidance of this kind. As pointed out above, Article 42(1) of the ICSID Convention provides that, in the absence of an agreement between the parties on applicable law, the domestic law of the host State and international law are to be applied. In the course of the deliberations leading to the ICSID Convention it was made clear that international law would prevail where the host State's domestic law violated international law, for instance through a subsequent change of its own law to the detriment of the investor.²⁶ The Chairman explained that international law would come into play both in the case of a lacuna in domestic law and in the event of an inconsistency between the two.²⁷

Relying on international law to serve a supplemental and corrective function in relation to domestic law has since found wide acceptance. While some commentators place greater emphasis on the host State's law²⁸ and others stress the importance of international law,²⁹ most commentators agree that international law is best used in this way to close any gaps in domestic law and to prevent any violations of international law that otherwise could arise through the application of the host State's law on its own.³⁰

²⁶ International Centre for Settlement of Investment Disputes (ed.), *Documents Concerning the Origin and the Formulation of the Convention* [hereinafter *History of the Convention*, Vol. II], pp. 570/1, 985 (1968).

²⁷ *Ibid.*, at 804.

²⁸ W. M. Reisman, "The Regime for *Lacunae* in the ICSID Choice of Law Provision and the Question of its Threshold", 15 *ICSID Review—FILJ* 362 (2000).

²⁹ P. Weil, "The State, the Foreign Investor and International Law: The No Longer Stormy Relationship of a *Ménage À Trois*", 15 *ICSID Review—FILJ* 401 (2000); E. Gaillard/Y. Banifatemi, "The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process", 18 *ICSID Review—FILJ* 375 (2003).

³⁰ A. Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", 136 *Recueil des Cours* 331, at 392 (1972-II); G. R. Delaume, "Transnational Contracts, Applicable Law and Settlement of Disputes Ch. XV", loose-leaf

The situation has been summarized succinctly by A. Broches. He writes with respect to the second sentence of Article 42(1) of the ICSID Convention, which provides for the application of domestic law and international law:

The Tribunal will first look at the law of the host State and that law will in the first instance be applied to the merits of the dispute. Then the result will be tested against international law. That 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.³¹

Arbitral awards do not always consider this point explicitly. In some decisions the tribunals looked at domestic law and at international law without any discussion of their relationship. In these cases the tribunals simply stated that the host State's domestic law was in conformity with international law or that the application of

68 *et seq.* (1990); P. Feuerle, "International Arbitration and Choice of Law under Art. 42 of the Convention on the Settlement of Investment Disputes", 4 *Yale Studies in World Public Order* 89, at 118 *et seq.* (1977); A. Giardina, "The International Centre for Settlement of Investment Disputes between States and Nationals of other States (ICSID)", in P. Sarcevic (ed.), *Essays on International Commercial Arbitration* 214, at 217 (1989); B. Goldman, "Le droit applicable selon la Convention de la B.I.R.D., du 18 mars 1965, pour le règlement des différends relatifs aux investissements entre Etats et ressortissants d'autres Etats", in *Investissements Etrangers et Arbitrage entre Etats et Personnes Privées, La Convention B.I.R.D.* 133, at 151 (1969); M. Hirsch, "The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes" 140 *et seq.* (1993); G. Jaenicke, "The Prospects for International Arbitration: Disputes between States and Private Enterprises", in A. H. A. Soons (ed.), *International Arbitration: Past and Prospects* 155, at 159 (1990); P. Kahn, "The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes", 44 *Indiana Law Journal* 1, at 27 *et seq.* (1968); E. Lauterpacht, "The World Bank Convention on the Settlement of International Investment Disputes", in *Recueil d'études de droit international en hommage à Paul Guggenheim* 642, at 660 (1968); M. Rubino-Sammartano, *International Arbitration Law* 55 (1990); O. Chukwumerije, "International Law and Municipal Law in ICSID Arbitration", 1 *Canadian Journal of International Business Law and Policy* 61, at 82 *et seq.* (1996); G. Elombi, "ICSID Awards and the Denial of Host State Law", 11 *Journal of International Arbitration* 61, at 66 *et seq.* (1994); V. C. Igbokwe, "Developing Countries and the Law Applicable to International Arbitration", 14 *Journal of International Arbitration* 99, at 114 *et seq.* (1997); N. Nassar, "Internationalization of State Contracts: ICSID, The Last Citadel", 14 *Journal of International Arbitration* 185, at 202 *et seq.* (1997); F. I. Shihata/A. R. Parra, "Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention", 9 *ICSID Review—FILJ* 183 (1994); C. Schreuer, *The ICSID Convention: A Commentary*, 622 *et seq.* (2001).

³¹ See Broches, *supra* note 30, at 392.

domestic law and of international law led to the same result.³² By applying both host State law and international law and affirming their consistency, these decisions confirm the need to apply both laws. However, they do not provide much guidance on the interaction between the two legal systems, and, in particular, on which law should prevail in the event of an inconsistency between them.

In another group of decisions, a more careful discussion of the interaction of international and national law can be observed. These cases follow the doctrine of the supplemental and corrective function of international law in relation to the host State's domestic law.

The *ad hoc* Committee in *Klöckner v. Cameroon* found that where the host State's domestic law had to be applied together with international law, the principles of international law had a dual role namely:

... *complementary* (in the case of a "lacuna" in the law of the State), or *corrective*, should the State's law not conform on all points to the principles of international law. *In both cases*, the arbitrators may have recourse to the "principles of international law" only *after* having inquired into and established the content of the law of the State party to the dispute (which cannot be reduced to *one* principle, even a basic one) and *after* having applied the relevant rules of the State's law.

Article 42(1) therefore clearly does not allow the arbitrator to base his decision *solely* on the "rules" or "principles of international law."³³

The Tribunal in *LETCO v. Liberia* reached a similar result. In discussing the system of concurrent law under the second sentence of Article 42(1) of the ICSID Convention it said:

The law of the Contracting State is recognized as paramount within its own territory, but is nevertheless subjected to control by international law. The role of international law as a "regulator" of national systems of law has been much discussed, with particular emphasis being focused on the problems likely to arise if there is divergence on a particular point between national and international law. No such problem arises in the present case; the Tribunal is satisfied that the rules and principles of Liberian law which it has taken into account are

³² *Adriano Gardella v. Côte d'Ivoire*, Award, 29 August 1977, 1 *ICSID Reports* 287; *Benvenuti & Bonfant v. Congo*, Award, 15 August 1980, 1 *ICSID Reports* 357; *Klöckner v. Cameroon*, Award, 21 October 1983, 2 *ICSID Reports* 63; *Amco v. Indonesia*, Award, 20 November 1984, 1 *ICSID Reports*, 466-467, 473, 490-494, 498-501, 504, 506.

³³ *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, 2 *ICSID Reports* 122. Italics original.

in conformity with generally accepted principles of public international law governing the validity of contracts and the remedies for their breach.³⁴

The *ad hoc* Committee in *Amco v. Indonesia* also subscribed to the formula of the supplemental and corrective function of international law:

20. It seems to the *ad hoc* Committee worth noting that Article 42(1) of the Convention authorizes an ICSID tribunal to apply rules of international law only to fill up lacunae in the applicable domestic law and to ensure precedence to international law norms where the rules of the applicable domestic law are in collision with such norms.

21. ... 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...³⁵

The second Tribunal in the resubmitted case of *Amco v. Indonesia* accepted that international law was 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. 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.³⁶

The Tribunal proceeded to examine the substantive questions before it in accordance with this method.³⁷

In *SPP v. Egypt*, the Tribunal found that Egyptian and international law had to be applied. It held that if municipal law contained a lacuna or if international law was violated by the exclusive application of municipal law, the Tribunal was bound to

³⁴ LETCO v. Liberia, Award, 31 March 1986, 2 *ICSID Reports*, 358-359.

³⁵ *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, 1 *ICSID Reports* 515.

³⁶ *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, 1 *ICSID Reports* 580.

³⁷ *Ibid.*, at 599, 604-605, 611-613, 617.

apply international law directly. The Tribunal said:

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.³⁸

The Tribunal applied international law in addition to national law in a variety of contexts. The Tribunal's findings on the awarding of interest provide insight into the interaction of national and international law. On the rate of interest it held that the determination must be made according to Egyptian law because there was no rule of international law that would fix the rate³⁹ However, the Tribunal observed that there was no provision in Egyptian law for determining the date from which interest would run for compensation for an act of expropriation. To fill this gap, the Tribunal applied international law, according to which interest would run from the date on which the dispossession effectively took place.⁴⁰

In *CDSE (Santa Elena) v. Costa Rica*, the Tribunal stated that the relevant rules and principles of Costa Rican law were generally consistent with international law. However, it added that in the event of inconsistency, public international law would have to prevail.⁴¹

This practice suggests that the starting point for an analysis in a case governed by a combined choice of law clause should be the host State's law. The result thus reached must then be checked against international law. International law may be used to close gaps left by national law and to correct a result achieved on the basis of domestic law that is in violation of international law. However, it is impermissible to apply international law alone and to ignore or bypass the host State's domestic law in this process.

The fact that international law has a corrective function and that domestic law that is in violation of international law is to be disregarded does not make the examination and application of domestic law superfluous. There are good reasons why the tribunals, in the cases cited above, insisted on the application of the host State's domestic law before turning to international law. Many questions are subject to detailed regulation in domestic law for which there is no corresponding rule in international law. The numerous provisions of civil law, commercial law, administrative law and corporate law of domestic legal systems illustrate this point. International law merely sets the

³⁸ *SPP v. Egypt*, Award, 20 May 1992, 3 *ICSID Reports* 208.

³⁹ *Ibid.*, at 241-242.

⁴⁰ *Ibid.*, at 243-244.

⁴¹ *CDSE v. Costa Rica*, Award, 17 February 2000, 15 *ICSID Review—FILJ* 191 (2000).

minimum standard against which provisions of domestic law must be checked. A decision that can be based on the host State's domestic law need not be sustained by reference to international law. A tribunal may give a decision based on the host State's domestic law, even if it finds no positive support in international law as long as the decision is not prohibited by any rule of international law.⁴² If the host State's law is more favourable than international law, including the BIT, the tribunal must give it precedence. All of this makes the initial examination and application of domestic law an indispensable step in the choice of law process.

The combined application of the host State's domestic law and international law is also in accordance with broader policy considerations. The host State has a legitimate interest in seeing its regulatory framework respected as long as that framework is not in violation of international law. The investor in selecting a market for its investment avails itself of the legal system prevailing there. Those who choose to invest in a particular market accept the existing market regulation subject to internationally recognized minimum standards.

II. Review in International Arbitration

In arbitration between States there is no institutionalized review. A claim by one State party that an award is void may be submitted to international adjudication by mutual consent. The International Court of Justice will decide on such a dispute only if there has been a submission to its jurisdiction.⁴³

A. The Role of National Courts

Typically, challenges to awards in commercial arbitration are brought in national courts. This includes awards made in non-ICSID investment disputes between States and foreign investors.⁴⁴ This function of review may be exercised by the courts of the country in which the tribunal had its seat or by the courts charged with the task of enforcing the award.⁴⁵ This would also apply to awards rendered under the Additional

⁴² See also Schreuer, *supra* note 30, at 631.

⁴³ See also International Law Commission, Model Rules on Arbitral Procedure, 1958, YILC, Vol. II, Arts. 36, 37.

⁴⁴ See especially D. Williams, "International Commercial Arbitration and Globalization. Review and Recourse against Awards rendered under Investment Treaties", 4 *The Journal of World Investment* 251 (2003).

⁴⁵ For an example, see the ICC Award in *SPP v. Egypt*, 11 March 1983, 3 *ICSID Reports* 46 and its treatment by domestic courts: District Court of Amsterdam, 12 July 1984, 3 *ICSID Reports* 92; Cour d'appel, Paris, 12 July 1984, 3 *ICSID Reports* 79; France, Cour de cassation,

Facility since these awards are not subject to ICSID's autonomous system of annulment. The trend in recent national legislation is to restrict the grounds for review and to give the parties some discretion to limit or even exclude review by national courts.⁴⁶

Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 lists the narrow grounds for refusing recognition and enforcement of an arbitral award at the request of a party.⁴⁷ The UNCITRAL Model Law on International Commercial Arbitration of 1985 also contemplates a limited number of grounds for setting aside or refusing to recognize an international commercial award by a domestic court. These grounds are closely modelled on Article V of the New York Convention.⁴⁸ Most national laws dealing with arbitration follow these grounds subject to certain variations.⁴⁹ Typically, the grounds for setting aside

6 January 1987, 3 *ICSID Reports* 96. See also C. Schreuer, *The ICSID Convention: A Commentary*, Art. 26, at 359-362, paras. 26-32.

⁴⁶ See e.g., C. M. Schmitthoff, "Finality of Arbitral Awards and Judicial Review", in J. D. M. Lew (ed.), *Contemporary Problems in International Arbitration* 230 (1986); A. Redfern/M. Hunter, *Law and Practice of International Commercial Arbitration* 419 *et seq.*, 429 *et seq.* (1991); W. L. Craig, "Uses and Abuses of Appeal from Awards", 4 *Arbitration International* 174, at 179 (1988); G.R. Delaume, "The Finality of Arbitration Involving States: Recent Developments", 5 *Arbitration International* 21, at 28 *et seq.* (1989); G. R. Delaume, "Reflections on the Effectiveness of International Arbitral Awards", 12 *Journal of International Arbitration* 5 (1995); C. M. Koa, "The International Bank for Reconstruction and Development and Dispute Resolution: Conciliating and Arbitrating with China through the International Centre for Settlement of Investment Disputes", 24 *New York University Journal of International Law and Politics* 439, at 472 *et seq.* (1991); T. de Berranger, "L'article 52 de la Convention de Washington du 18 mars 1965 et les premiers enseignements de sa pratique", *Revue de l'Arbitrage* 93, at 113 *et seq.* (1988); and see the references cited by B. Pirrwitz, "Annulment of Arbitral Awards Under Art. 52 of the Washington Convention on the Settlement of Investment Disputes Between States and Nationals of Other States", 23 *Texas International Law Journal* 73, at 78 (1988).

⁴⁷ 330 *UNTS* 38 (1959). See D. H. Freyer/H. G. Gharavi, "Finality and Enforceability of Foreign Arbitral Awards: From "Double Exequatur" to the Enforcement of Annulled Awards: A Suggested Path to Uniformity Amidst Diversity", 13 *ICSID Review—FILJ* 101 (1998). See also Parra, *supra* note 11, at 300 *et seq.* and the authorities cited there.

⁴⁸ Arts. 34, 36. 24 *ILM* 1302, at 1311 (1985).

⁴⁹ See A. Redfern/M. Hunter, *Law and Practice of International Commercial Arbitration*, 420 *et seq.* (1999); E. Gailard, J. Savage, *Fouchard, Gaillard, Goldmann On International Commercial Arbitration*, 922 *et seq.* (1999); W.M. Reisman/W.L. Craig/W. Park/J. Paulsson, *International Commercial Arbitration*, 1081 *et seq.* (1997); F.- B. Weigand, (ed.), *Practitioner's handbook on International Arbitration*, 579 *et seq.*, 634 *et seq.*, 676 *et seq.*, 810 *et seq.*, 875 *et seq.*, 940 *et seq.*, 991 *et seq.*, 1040 *et seq.*, 1076 *et seq.*, 1135 *et seq.* (2002)

include an excess of authority by the arbitral tribunal.⁵⁰

B. Annulment under the ICSID Convention

ICSID awards are not subject to review by domestic courts. Rather, ICSID offers its autonomous and self-contained review process. Applications for annulment are examined by an *ad hoc* Committee that is appointed by the Chairman of ICSID's Administrative Council.⁵¹

The grounds for annulment are defined in Article 52(1) of the ICSID Convention. These grounds for annulment include "that the Tribunal has manifestly exceeded its powers".

C. Governing Law and Nullity

The tribunal is bound by the arbitration agreement and the instructions of the parties contained therein. Any substantial deviation from the arbitration agreement by the tribunal constitutes an excess of powers or excess of authority (*excès de pouvoir*). The applicable law is one of the issues that may be agreed by the parties in their arbitration agreement. An agreement on applicable law or choice of law is an essential part of the framework for decision that the tribunal is bound to observe. Therefore, non-observance of an agreement on applicable law may amount to an excess of powers and can lead to nullity. On the other hand, a mere error in the application of the governing law is not a ground for annulment.⁵²

As pointed out above, Article 52 of the ICSID Convention includes among the reasons for annulment "that the Tribunal has manifestly exceeded its powers;" During the drafting of this provision⁵³ the Chairman explained that while a mistake in applying the law would not be a valid ground for annulment, applying a different law from that agreed to by the parties would lead to an award that could be properly challenged on

⁵⁰ See D. Williams, "International Commercial Arbitration and Globalization. Review and Recourse against Awards rendered under Investment Treaties", 4 *The Journal of World Investment* 251, at 264 *et seq.* (2003).

⁵¹ For an extensive analysis of ICSID's annulment procedure see Schreuer, *supra* note 30, at 881 *et seq.* For a more concise description see: http://www.unctad.org/en/docs/edmmisc232add7_en.pdf.

⁵² For an incisive analysis of the distinction between annulment and appeal see D. D. Caron, "Reputation and Reality in the ICSID Annulment Process: Understanding the Distinction Between Annulment and Appeal", 7 *ICSID Review—FILJ* 21 (1992).

⁵³ For a more extensive analysis of the Convention's *travaux préparatoires* on this point see Schreuer, *supra* note 30, at 943 *et seq.*

the ground that the arbitrators had gone against the terms of the *compromis*.⁵⁴ A failure to apply the governing law would constitute an excess of powers if the parties had instructed the tribunal to apply a particular law.⁵⁵ This view is widely shared by scholars writing on this topic.⁵⁶

III. Practical Consequences of a Failure to Apply the Governing Law

In a number of cases complaints about a failure to apply the governing law by an international tribunal were raised in proceedings for the setting aside or annulment of the awards. The majority of these were decided in the framework of the ICSID Convention. In fact, every published decision on annulment before an ICSID *ad hoc* Committee has included a complaint of failure to apply the governing law.⁵⁷ Other cases were decided outside the framework of ICSID by domestic courts. The standards applied by the reviewing bodies and the resulting decisions differ widely. They range from detailed scrutiny of the reasoning underlying the award, to refusal to set aside despite deviation from the governing law. Six cases will be examined in turn.

⁵⁴ History of the Convention, Vol. II, *supra* note 26, at 518.

⁵⁵ *Ibid.*, at 851.

⁵⁶ See *esp.* de Berranger, *supra* note 46, at 108; A. Broches, "Observations on the Finality of ICSID Awards", 6 *ICSID Review—FILJ* 321 (1991); E. Gaillard, "Centre International pour le Règlement des Différends relatifs aux Investissements (CIRDI): Chronique des sentences arbitrales", 114 *Journal du Droit International* 135, at 188 *et seq.* (1987); F. Niggemann, "Das Washingtoner Weltbankübereinkommen von 1965—Das Nichtigkeitsverfahren im Ad-Hoc-Komitee", 4 *Jahrbuch für die Praxis der Schiedsgerichtsbarkeit* 97, at 109 *et seq.* (1990); B. Pirrwitz, "Annulment of Arbitral Awards Under Art. 52 of the Washington Convention on the Settlement of Investment Disputes Between States and Nationals of Other States", 23 *Texas International Law Journal* 73, at 103 *et seq.* (1988); P. Rambaud, "L'annulation des sentences Klöckner et Amco", 32 *Annuaire Français de Droit International* 259, at 263 *et seq.* (1986); W. M. Reisman, "The Regime for *Lacunae* in the ICSID Choice of Law Provision and the Question of its Threshold", 15 *ICSID Review—FILJ* 362, 370-371 (2000); I. Seidl-Hohenveldern, "Die Aufhebung von ICSID Schiedssprüchen", 2 *Jahrbuch für die Praxis der Schiedsgerichtsbarkeit* 100, at 104 (1989); Schreuer, *supra* note 30, at 555 *et seq.*, 943 *et seq.*

⁵⁷ In *Compañía de Aguas del Aconquija, S. A. & Compagnie Générale des Eaux v. Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 41 *ILM* 1135 (2002) failure to apply the proper law was raised by the Applicant in the annulment proceedings. But the *ad hoc* Committee annulled part of the Award for other reasons and did not address this ground for annulment. Therefore, *Vivendi* is not dealt with in this article.

A. *Klöckner v. Cameroon: The Quality of Reasoning*

The annulment proceedings in *Klöckner v. Cameroon*⁵⁸ demonstrated the importance not only of applying both domestic and international law, where each is required, but also of doing so clearly and explicitly. In *Klöckner*, the parties had concluded a series of contracts for the supply and management of a fertilizer factory. After a period of unprofitable operation the factory was shut down by the Cameroonian Government. Klöckner filed a request for ICSID arbitration claiming the balance of the price of the factory. The Government counter-claimed damages for losses it had incurred in the project.

The parties had not agreed upon the applicable law. Therefore, the second sentence of Article 42(1) of the ICSID Convention became operative. That provision directs the Tribunal to apply the law of the State party to the dispute and such rules of international law as may be applicable.

The Tribunal determined that it had to apply the civil and commercial law applicable in Cameroon, which in its relevant part was based on French law.⁵⁹ In doing so, it found that Klöckner's behaviour constituted a breach of the principle of confidence, loyalty and openness which it took to be a basic principle of French law and of other national codes. The Tribunal said:

We take for granted that the principle according to which a person who engages in close contractual relations, based on confidence, must deal with its partner in a frank, loyal and candid manner is a basic principle of French civil law, as is indeed the case under the other national codes which we know of. This is the criterion that applies to relations between partners in simple forms of association anywhere. The rule is particularly appropriate in more complex international ventures, such as the present one.⁶⁰

The Tribunal did not substantiate this statement with any further reference to French law but continued to refer to "universal requirements of frankness and loyalty."⁶¹ It found that Klöckner had not dealt frankly with Cameroon but had "violated its contractual obligation of full disclosure"⁶² and, therefore, did not have a right to the full contract price.⁶³

⁵⁸ For a full report of the case see 2 *ICSID Reports* 4.

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

⁶⁰ *Ibid.*, at 59.

⁶¹ *Ibid.*, at 60.

⁶² *Ibid.*, at 61.

⁶³ *Ibid.*, at 60-61.

Klöckner requested the annulment of the Award citing excess of powers for failure to apply the governing law as one of the grounds. The *ad hoc* Committee, that decided the application for annulment, adopted the distinction between the non-application of the governing law and a mere error in its application. It said:

60. While the complaint based on failure to observe Article 42 is thus admissible in principle, it remains to be determined what exactly constitutes not deciding “in accordance with such rules of law as may be agreed by the parties,” or not “applying the law of the Contracting State party to the dispute.” This raises the fine distinction between “non-application” of the applicable law and mistaken application of such law.

61. It is clear that “*error in iudicando*” could not in itself be accepted as a ground for annulment without indirectly reintroducing an appeal against the arbitral award, and the *ad hoc* Committee under Article 52 of the Convention does not, any more than the Permanent Court of Arbitration in the *Orinoco* case, have the “duty ... to say if the case has been well or ill judged, but whether the award must be annulled.”⁶⁴

The *ad hoc* Committee, in examining the Tribunal’s reasoning above, found that the relevant French law had not been applied. It said:

67. It may immediately be noticed that here the Tribunal does not claim to ascertain the existence (of a rule or a principle) but asserts or postulates the existence of such a “principle” which (after having postulated its existence) the Tribunal *assumes* or takes for granted that it “is a basic principle of French civil law.”⁶⁵

The absence of specific legal authority made it impossible to determine whether the governing law had been applied:

71. Does the “basic principle” referred to by the Award ... as one of “French civil law” come from positive law, i.e., from the law’s body of rules? It is impossible to answer this question by reading the Award, which contains no reference whatsoever to legislative texts, to judgments, or to scholarly opinions.⁶⁶

The *ad hoc* Committee took the Tribunal’s reliance on a universal requirement of frankness and loyalty as a reference to general principles of law. It deplored the absence of any authority for these general principles or universal requirements⁶⁷ and

⁶⁴ Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 *ICSID Reports* 119.

⁶⁵ *Ibid.*, at 121. Italics original.

⁶⁶ *Ibid.*, at 122.

⁶⁷ *Ibid.*, at 123.

concluded that the Award's reasoning seemed more like a simple reference to equity.⁶⁸ On the permissibility to resort to international law the *ad hoc* Committee said:

the arbitrators may have recourse to the "principles of international law" only *after* having inquired into and established the content of the law of the State party to the dispute (which cannot be reduced to *one* principle, even a basic one) and *after* having applied the relevant rules of the State's law.

Article 42(1) therefore clearly does not allow the arbitrator to base his decision *solely* on the "rules" or "principles of international law."⁶⁹

The *ad hoc* Committee also found it unacceptable that the Tribunal had simply asserted the existence of a domestic legal principle without relying on any sources. The absence of specific legal authority made it impossible to determine whether the governing law had been applied:

71. Does the "basic principle" referred to by the Award ... as one of "French civil law" come from positive law, i.e., from the law's body of rules? It is impossible to answer this question by reading the Award, which contains no reference whatsoever to legislative texts, to judgments, or to scholarly opinions.⁷⁰

The *ad hoc* Committee was less concerned with the substantive correctness of the Award than with the way it was presented. It was unwilling to inquire on its own initiative whether an obligation of full disclosure did, in fact, exist in French law:

73. It is not the responsibility of the *ad hoc* Committee under Article 52 to determine instead of the Tribunal what rules of French civil law might be applicable, to insert them in some *a posteriori* way into the Award, either in place of the reasoning found there and cited above, or in place of non-existent reasoning. The Committee can only take the Award *as it is*, interpreting it according to the customary principles of interpretation, and find that it indeed refers to general principles or "universal requirements," postulated rather than demonstrated, and which are affirmed as being "particularly appropriate" or "particularly important" in cases such as the present one.⁷¹

The *ad hoc* Committee also addressed the question of an unauthorized decision *ex*

⁶⁸ *Ibid.*, at 124.

⁶⁹ *Ibid.*, at 122. Italics original.

⁷⁰ *Ibid.*, at 122.

⁷¹ *Ibid.*, at 123. Italics original.

aequo et bono.⁷² It said:

Excess of powers may consist of the non-application by the arbitrator of the rules contained in the arbitration agreement (*compromis*) or in the application of other rules. Such may be the case if the arbitrator ... reaches a solution *in equity* while he is required to decide *in law*...⁷³

Since the parties had not authorized the Tribunal to decide *ex aequo et bono*, the *ad hoc* Committee held that the Tribunal's broad finding on an obligation of full disclosure amounted to an unauthorized resort to equitable principles:

77. Now, the Award's reasoning and the legal grounds on this topic (...) seem very much like a simple reference to equity, to "universal" principles of justice and loyalty, such as amiable compositeurs might invoke.⁷⁴

This, in the Committee's view, constituted a manifest excess of powers since the Tribunal had acted

... outside the framework provided by Article 42(1), applying concepts or principles it probably considered equitable (acting as an amiable compositeur, which should not be confused with applying "equitable considerations" as the International Court of Justice did in the *Continental Shelf* case). However justified its award may be (a question on which the Committee has no opinion), the Tribunal thus "manifestly exceeded its powers" within the meaning of Article 52(1)(b) of the Washington Convention.⁷⁵

It followed that the Tribunal had not applied the governing law:

79. *In conclusion*, it must be acknowledged that in this reasoning, limited to postulating and not demonstrating the existence of a principle or exploring the rules by which it can only take concrete form, the Tribunal has not applied "the law of the Contracting State."⁷⁶

It followed that the Award had to be annulled in its entirety.⁷⁷

⁷² Art. 42(3) of the ICSID Convention provides: "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."

⁷³ Klöckner v. Cameroon, Decision on Annulment, 3 May 1985, 2 *ICSID Reports* 119. Italics original.

⁷⁴ *Ibid.*, at 124.

⁷⁵ *Ibid.*, at 125.

⁷⁶ *Ibid.*, at 125. Italics original.

⁷⁷ The dispute was resubmitted to a second Tribunal, which rendered an award that has remained unpublished. Both parties requested annulment of the second Award. The Decision of the

The annulment decision in *Klöckner* has attracted criticism.⁷⁸ In particular, it was argued that the Tribunal had identified the applicable law correctly but had merely erred in the details of its application. The *ad hoc* Committee in *Klöckner* seemed less concerned with whether the governing law was applied and how it was applied than with the quality of the reasoning underlying its application. The main shortcoming of the Tribunal's reasoning in *Klöckner* was its laxity in citing sources and its failure to rely on specific legal authority.

B. *Amco v. Indonesia*: The Neglect of One Provision

The decision to annul in *Amco v. Indonesia*⁷⁹ was based on the Tribunal's failure to apply a single key provision of the governing law. The dispute in *Amco* arose from agreements to develop and manage a hotel and office block in Indonesia. As part of these arrangements, the investor undertook to invest at least three million U.S. Dollars in equity capital in the project. The project proceeded and the hotel was in operation when a dispute arose between the investor and its local partner PT Wisma. As a consequence, PT Wisma took over control of the hotel with the assistance of members of the Indonesian armed forces. Shortly thereafter, the Indonesian authorities revoked the Claimant's investment licence. One of the reasons for the revocation was that the investor had not invested the full three million U.S. Dollars in equity capital. Amco submitted a request for ICSID arbitration.

The Tribunal found that, since the Parties had not chosen a governing law, Indonesian law and such rules of international law as it deemed applicable were to be

second *ad hoc* Committee, which has also remained unpublished, rejected the requests for annulment.

⁷⁸ Broches, *supra* note 56, at 360 *et seq.*; M. B. Feldman, "The Annulment Proceedings and the Finality of ICSID Arbitral Awards", 2 *ICSID Review—FILJ* 85, at 92, 101 *et seq.* (1987); J. Paulsson, "ICSID's Achievements and Prospects", 6 *ICSID Review—FILJ* 380, at 389 (1991); Pirwitz, *supra* note 46, at 103, 106; D. A. Redfern, "ICSID—Losing its Appeal?", 3 *Arbitration International* 98, at 106 *et seq.* (1987); W. M. Reisman, "The Breakdown of the Control Mechanism in ICSID Arbitration", 38 *Duke Law Journal* 739, at 766 *et seq.* (1989); de Berranger, *supra* note 46, at 112, 114; Gaillard, *supra* note 56, at 140; P. Kahn, "Le contrôle des sentences arbitrales rendues par un Tribunal CIRDI", in Société française pour le droit international (ed.), *La juridiction internationale permanente. Colloque de Lyon* 363, at 376 (1987); C. Schreuer, "Decisions Ex Aequo et Bono Under the ICSID Convention", 11 *ICSID Review—FILJ* 37, 57-59 (1996).

⁷⁹ For a full report of the case see 1 *ICSID Reports* 377. See also M. Leigh, "Arbitration—Annulment of Arbitral Award for Failure to Apply Law Applicable Under ICSID Convention and Failure to State Sufficiently Pertinent Reasons", 81 *American Journal of International Law* 222 (1987).

applied by virtue of the second sentence of Article 42(1) of the ICSID Convention.⁸⁰ The Tribunal examined a number of legal questions from the perspectives of Indonesian law and international law and it found that both systems led to the same result.⁸¹

The Tribunal calculated the total sum of actual investments at U.S. \$2,472,490 and concluded that the shortfall in relation to the required amount of U.S. \$3,000,000 had been immaterial and this did not justify the revocation of Amco's investment licence.⁸²

Indonesia requested annulment relying on several grounds including excess of powers for failure to apply the governing law.

The *ad hoc* Committee that decided the request for annulment had no doubt that failure to apply the governing law constituted an excess of powers and hence a ground for annulment. Like the *Klöckner ad hoc* Committee, it too distinguished a failure to apply the governing law from an error in its application:

23. The law applied by the Tribunal will be examined by the *ad hoc* Committee, not for the purpose of scrutinizing whether the Tribunal committed errors in the interpretation of the requirements of applicable law or in the ascertainment or evaluation of the relevant facts to which such law has been applied. Such scrutiny is properly the task of a court of appeals, which the *ad hoc* Committee is not. The *ad hoc* Committee will limit itself to determining whether the Tribunal did in fact apply the law it was bound to apply to the dispute. Failure to apply such law, as distinguished from mere misconstruction of that law, would constitute a manifest excess of powers on the part of the Tribunal and a ground for nullity under Article 52(1)(b) of the Convention. The *ad hoc* Committee has approached this task with caution, distinguishing failure to apply the applicable law as a ground for annulment and misinterpretation of the applicable law as a ground for appeal.⁸³

⁸⁰ *Amco v. Indonesia*, Award, 20 November 1984, 1 *ICSID Reports* 452.

⁸¹ *Ibid.*, at 466-467, 473, 490-494, 498-501, 504, 506.

⁸² *Ibid.*, at 489.

⁸³ *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, 1 *ICSID Reports* 515-516. Despite this distinction in theory, the *ad hoc* Committees in *Klöckner* and in *Amco* have been criticized for actually examining the substantive correctness of the Awards before them. Commentators have criticized these two decisions as having overstepped the line between annulment and appeal by looking also at the question of how the applicable law had been applied. See Gaillard, *supra* note 56, at 189; F. Niggemann, „Das Washingtoner Weltbankübereinkommen von 1965—Das Nichtigkeitsverfahren im Ad-Hoc-Komitee“, 4 *Jahrbuch für die Praxis der Schiedsgerichtsbarkeit* 97, at 110 *et seq.* (1990); Schreuer, *supra* note 30, at 558, 948; M. Sturzenegger, „ICSID Arbitration and Annulment for Failure to State Reasons“, 9 *Journal of International Arbitration* 173, at 179 (1992).

The *ad hoc* Committee had no doubt as to the relevance of the host State's law:

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 ...⁸⁴

The *ad hoc* Committee found the Tribunal's calculation of the amounts invested faulty since, under the relevant provision of Indonesian law, only amounts recognized and registered by the competent Indonesian authority were investments within the meaning of the Foreign Investment Law. Amco had not complied with the approval and registration formalities for all the amounts involved. The *ad hoc* Committee concluded:

95. The evidence before the Tribunal showed that as late as 1977, Amco's investment of foreign capital duly and definitely registered with Bank Indonesia in accordance with the Foreign Investment Law, amounted to only US \$983,992 The Tribunal in determining that the investment of Amco had reached the sum of US \$2,472,490 clearly failed to apply the relevant provisions of Indonesian law. The *ad hoc* Committee holds that the Tribunal manifestly exceeded its powers in this regard and is compelled to annul this finding.⁸⁵

In other contexts, however, the *ad hoc* Committee rejected the contention that the Tribunal had committed an excess of powers by failing to apply the governing law. Indonesia claimed that the Tribunal had manifestly exceeded its powers and had failed to state any reasons in holding Indonesia responsible for the hotel's forcible takeover by army and police personnel on the basis of international law.⁸⁶ In Indonesia's view, the Tribunal should have established whether Indonesian law provided a special duty to protect foreign investors and their property. The *ad hoc* Committee rejected this argument:

The *ad hoc* Committee reads this portion of the Award to mean that the Tribunal found the acts of PT Wisma, and therefore also the acts of the army and police personnel involved, to be illegal under Indonesian law. It is true that the Tribunal did not refer to any specific Indonesian statutory or regulatory provision nor to any Indonesian case-law, but this omission is no more decisive of non-application of Indonesian Law than it is indicative of an intent on the part of the Tribunal, at that point in the Award, to apply international law.⁸⁷

⁸⁴ *Ibid.*, at 515.

⁸⁵ *Ibid.*, at 534-535.

⁸⁶ See *Amco v. Indonesia*, Award, *supra* note 80, at 458-459.

⁸⁷ *Amco v. Indonesia*, Decision on Annulment, *supra* note 83, at 524.

The *ad hoc* Committee proceeded to reconstruct the situation in Indonesian law. It concluded that there was a duty under Indonesian law to protect a person in actual peaceful possession of property. Therefore, the *ad hoc* Committee was unable to sustain the contention that the Tribunal had failed to apply Indonesian law.⁸⁸

In another part of the Award, the Tribunal held that the procedure leading to the revocation of the investment license had not offered the investor a fair and adequate hearing and therefore had been contrary “to the general and fundamental principle of due process”.⁸⁹ Before the *ad hoc* Committee Indonesia argued that Indonesian administrative law did not include any general principles or standards of due process. Nor did the words “due process” appear in Indonesia’s Constitution. But Indonesia admitted that Indonesian law offered redress against administrative decisions on the basis of certain general standards.⁹⁰ Despite the Tribunal’s failure to define the conditions for its “general and fundamental principle”, the *ad hoc* Committee held:

It appears to the *ad hoc* Committee that these general standards of Indonesian law are not qualitatively different from, and seem equivalent in a functional sense to, what the Tribunal appears to have had in mind in referring to “the general and fundamental principle of due process”.⁹¹

Therefore, the *ad hoc* Committee held that this part of the Award was not vitiated by a failure to apply the governing law amounting to a manifest excess of powers nor by failure to state reasons.⁹²

The *ad hoc* Committee rejected also other contentions of failure to apply the governing law in connection with alleged technical errors concerning Indonesian law.⁹³ These examples show that this Committee did not take the tribunal’s failure to cite specific authority for the rules it applied as a failure to apply the governing law as long as the rule applied was, in fact, in accord with the applicable law.

In *Amco* there was also no authorization to decide *ex aequo et bono* and the Tribunal recognized this explicitly.⁹⁴ Unlike the *Klöckner ad hoc* Committee, however, the *ad hoc* Committee in *Amco* rejected the idea that every reliance on broad principles or equitable considerations amounted to an impermissible decision *ex aequo et bono*. The *ad hoc* Committee in *Amco* also found that the Tribunal did not need to base each

⁸⁸ *Ibid.*, at 525.

⁸⁹ *Amco v. Indonesia*, Award, *supra* note 80, at 472-473.

⁹⁰ *Amco v. Indonesia*, Decision on Annulment, *supra* note 83, at 529-530.

⁹¹ *Ibid.*, at 530.

⁹² *Ibid.*, at 530.

⁹³ *Ibid.*, at 526-527, 528-529, 530-531, 532.

⁹⁴ *Amco v. Indonesia*, Award, *supra* note 80, at 452.

finding on a specific legal rule. It said:

25. At the same time, the *ad hoc* Committee does not believe that the Tribunal had necessarily to preface each finding or conclusion with a specification of the Indonesian or international law rule on which such finding or conclusion rests. The Tribunal's conclusions or findings must of course be read in their context (...).

26. Neither does the *ad hoc* Committee consider that any mention of "equitable consideration" in the Award necessarily amounts to a decision *ex aequo et bono* and a manifest excess of power on the part of the Tribunal. Equitable considerations may indeed form part of the law to be applied by the Tribunal, whether that be the law of Indonesia or international law.⁹⁵

The *ad hoc* Committee concluded that while an unauthorized decision *ex aequo et bono* would have amounted to an excess of powers, the Tribunal had not, in fact, applied equity instead of 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* which, in view of the determination of the law applicable to the present case ..., would constitute a decision annulable for manifest excess of powers. Nullity would be a proper result only where the Tribunal decided an issue *ex aequo et bono* in lieu of applying the applicable law.⁹⁶

In the end, the *ad hoc* Committee decided to annul the Award, with the exception of the Tribunal's finding as to the illegality of the hotel's armed takeover. The *ad hoc* Committee found that the Tribunal had correctly identified the applicable law but it had failed to apply that law when calculating the shortfall of the amount that had been invested. It followed that the Tribunal's finding as to the illegality of the withdrawal of the investment licence, its findings on the amount of damages and its rejection of certain Indonesian counter-claims had to be annulled as well.⁹⁷

⁹⁵ *Amco v. Indonesia*, Decision on Annulment, *supra* note 83, at 516.

⁹⁶ *Ibid.*, at 517.

⁹⁷ *Ibid.*, at 537 *et seq.* The case was resubmitted to a new Tribunal, which rendered a preliminary Decision on Jurisdiction determining mainly which parts of the Award had been annulled and which were *res judicata*: *Amco v. Indonesia*, Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 *ICSID Reports* 543. In a new Award on the merits, the new Tribunal awarded damages to Amco for the general disturbance entailed by the loss of the right to manage: *Amco v. Indonesia*, Resubmitted Case: Award, 5 June 1990, 1 *ICSID Reports* 569. Both parties requested annulment of the second Award. The Decision of the second *ad hoc* Committee rejected the requests for annulment. This decision has remained unpublished.

The *Amco* decision demonstrates that the omission or neglect of a single provision in the applicable law may lead to annulment. The Tribunal had identified the applicable law, including Indonesian law, correctly and had purported to apply it. It had even identified and analyzed the relevant legislation, the Foreign Investment Law,⁹⁸ but it had not applied a particular provision of that law. In the *ad hoc* Committee's view, the non-application of one important rule of Indonesian law dealing with the approval and registration of invested capital was enough to annul the Award.

The annulment of major parts of the Award in *Amco* on the ground that the Tribunal had overlooked a provision of the applicable law is difficult to reconcile with the distinction between failure to apply the applicable law and a mere error in the application of that law. The Tribunal undertook a detailed examination of Indonesian law and, in particular, of the Foreign Investment Law quoting some of its provisions. To speak of a non-application that is distinguishable from an erroneous application in this context is not meaningful. The *ad hoc* Committee simply came to a different interpretation and described what it perceived as an erroneous application as a non-application.⁹⁹

C. *MINE v. Guinea: A Minor Technical Error*

The decision in the annulment proceedings in *MINE v. Guinea*¹⁰⁰ indicates that mere technical flaws will not result in the overturning of an award. The dispute arose from contracts for the creation of facilities to ship bauxite. The parties had agreed on Guinean law subject to a stabilization clause.¹⁰¹ The Tribunal found that Guinea had violated the principle of good faith and had breached its contractual obligation. Therefore it awarded damages to MINE.¹⁰²

Guinea requested the annulment of the Award. One of the reasons for the request was an alleged excess of powers for failure to apply the governing law. Before the Tribunal, MINE had relied on Article 1134 of the Code Civil de l'Union Française, applicable in Guinea and containing the principles of *pacta sunt servanda* and good faith. The Tribunal had erred in that it had cited Article 1134 of the French Civil

⁹⁸ *Amco v. Indonesia*, Award, *supra* note 80, at 482-485.

⁹⁹ This view was shared by the new Tribunal established under Art. 52(6) of the ICSID Convention. See *Amco v. Indonesia*, Resubmitted Case: Decision on Jurisdiction, 10 May 1988, 1 *ICSID Reports* 559.

¹⁰⁰ For a full report of this case see 4 *ICSID Reports* 54.

¹⁰¹ *MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 *ICSID Reports* 94-95.

¹⁰² *MINE v. Guinea*, Award, 6 January 1988, 4 *ICSID Reports* 73.

Code instead.¹⁰³ In its Application for Annulment, Guinea claimed that the Tribunal had “failed to apply any law, let alone the correct law” thereby committing a manifest excess of powers.¹⁰⁴

The *ad hoc* Committee confirmed the principle that a failure to apply the governing law would constitute an excess of powers leading to the Award’s annulment. It also emphasized the distinction between the non-application and the erroneous application of the governing law:

... the parties’ agreement on applicable law forms part of their arbitration agreement. Thus, a tribunal’s disregard of the agreed rules of law would constitute a derogation from the terms of reference within which the tribunal has been authorized to function. Examples of such a derogation include the application of rules of law other than the ones agreed by the parties, or a decision not based on any law unless the parties had agreed on a decision *ex aequo et bono*. If the derogation is manifest, it entails a manifest excess of power.

5.04 Disregard of the applicable rules of law must be distinguished from erroneous application of those rules which, even if manifestly unwarranted, furnishes no ground for annulment (...).¹⁰⁵

The *ad hoc* Committee held that the technical error in the award did not warrant annulment:

6.40 There is thus no basis for saying that the Tribunal failed to apply any law. Admittedly, the Tribunal erred in citing Article 1134 of the French Civil Code. The Committee notes, however, that the relevant provision of the applicable Guinean law is contained in the “Code Civil de l’Union Française” with the same number and the same contents as Article 1134 of the French Civil Code. For this reason, the Committee does not consider that this error warrants annulment.¹⁰⁶

As a result, the *ad hoc* Committee did not annul the portion of the Award that had held Guinea to be in breach of contract. In the *ad hoc* Committee’s view, the Tribunal had correctly applied the governing law.¹⁰⁷

¹⁰³ *Ibid.*, at 73.

¹⁰⁴ See *MINE v. Guinea*, Decision on Annulment, *supra* note 101, at 95.

¹⁰⁵ *Ibid.*, at 87.

¹⁰⁶ *Ibid.*, at 96.

¹⁰⁷ But the *ad hoc* Committee annulled the damages section of the Award because the Tribunal had failed to deal with essential questions raised by Guinea. In addition, the Tribunal had contradicted itself in adopting its damages theory. *Ibid.*, at pp. 107-108. MINE resubmitted the damages question for decision by a new tribunal. The parties subsequently reached a settlement by agreement and the proceedings were discontinued.

This decision appears entirely convincing. A mere error in identifying the name of an applicable piece of legislation cannot be described as a failure to apply the governing law.

D. *Wena Hotels v. Egypt*: International Law Prevails in the Event of a Conflict

The decision on annulment in *Wena Hotels Ltd v. Arab Republic of Egypt*¹⁰⁸ shows the interaction between domestic and international law in cases in which they both apply. In *Wena Hotels*, the investor, a British national, had entered into agreements with EHC, an Egyptian public sector company, for the lease, development and management of two hotels in Luxor and Cairo. Disputes arose between EHC and Wena concerning their respective obligations. After attacks leading to a forcible takeover, EHC took control of the hotels. The Egyptian authorities recognized the illegality of the attacks and takeover and the hotels were returned to the investor. Wena initiated several domestic arbitrations against EHC in respect of the two hotels. As a consequence of these arbitrations, Wena received some damages but lost control of the hotels.

Wena then initiated ICSID arbitration against Egypt on the basis of the BIT between Egypt and the United Kingdom. That BIT did not contain a provision on applicable law. In its statement on applicable law¹⁰⁹ the Tribunal found that the parties were in agreement that the case turned on the alleged violation of the BIT. Therefore, the BIT was the primary source of applicable law. The Tribunal found that there was no special agreement between the parties on applicable law. Therefore, under the second sentence of Article 42(1) of the ICSID Convention the Host State's law and international law was applicable. The Tribunal drew the following conclusion:

The Tribunal notes that the provisions of the IPPA [i.e. the BIT] would in any event be the first rules of law to be applied by the Tribunal, both on the basis of the agreement of the parties and as mandated by Egyptian law as well as international law.¹¹⁰

On the basis of the BIT, the Tribunal found that Egypt had violated its obligations to provide "fair and equitable treatment", "full protection and security" and had failed to provide Wena with "prompt, adequate and effective compensation" following the

¹⁰⁸ For a full report of this case see 41 *ILM* 896, at 900-910, 933, 939-943 (2002).

¹⁰⁹ *Wena Hotels Ltd v. Arab Republic of Egypt*, Award, 8 December 2000, 41 *ILM* 896, at 910-911, paras. 78-79 (2002).

¹¹⁰ *Ibid.*, at 911.

expropriation of the investment. It awarded a substantial amount of damages including interest at the rate of 9% compounded quarterly.¹¹¹

Egypt's request for annulment was based on several grounds including manifest excess of powers for failure to apply the governing law. In particular, Egypt argued that the Tribunal had failed to apply Egyptian law contrary to Article 42(1) of the ICSID Convention.

The *ad hoc* Committee, citing the decisions in *Klöckner*, *Amco* and *MINE*, confirmed the principle that failure to apply the governing law may constitute a manifest excess of power and a ground for annulment. It also stated that it was

mindful of the distinction between failure to apply the proper law and the *error in iudicando* drawn in *Klöckner I*, and the consequential need to avoid the reopening of the merits in proceedings that would turn annulment into appeal.¹¹²

The *ad hoc* Committee found that the parties to the dispute before it had not made a choice of law. While the agreements between Wena and EHC were clearly subject to Egyptian law, the relationship between Wena and Egypt was of a different nature.¹¹³ Therefore, the second sentence of Article 42(1), directing the tribunal to apply the host State's law and applicable rules of international law, governed the issue.¹¹⁴ The *ad hoc* Committee undertook a somewhat inconclusive discussion of the relationship of international law and domestic law.¹¹⁵ In this regard the *ad hoc* Committee found that both legal orders have a role but that in the event of inconsistency international law would prevail. The BIT and the ICSID Convention were in accord with Egyptian law and they were part of it. Therefore, the Tribunal, in relying on the BIT as the primary source of law, did not exceed its powers.¹¹⁶

The application for annulment relied on the ground of excess of powers for failure to apply the governing law in several contexts.¹¹⁷ Egypt contended that the Tribunal should have considered the extent and nature of the rights under the leases as governed by Egyptian law. It also criticised the fact that the ICSID Tribunal had failed to take proper account of one of the domestic arbitral awards between Wena and EHC. This,

¹¹¹ *Ibid.*, at 918-920.

¹¹² *Wena Hotels Ltd v. Arab Republic of Egypt*, Decision on Annulment, 28 January 2002, 41 *ILM* 933, at 939 (2002).

¹¹³ *Ibid.*, at 940.

¹¹⁴ *Ibid.*, at 941.

¹¹⁵ *Ibid.*, at 941.

¹¹⁶ *Ibid.*, at 942.

¹¹⁷ Egypt's complaints in the context of an alleged corruption were dismissed as relating to questions of evidence and not applicable law. *Ibid.*, at 942.

alleged Egypt, amounted to a failure to apply the proper law and a manifest excess of powers.

The *ad hoc* Committee rejected this argument. It distinguished the relationship between Wena and EHC from that of Wena and Egypt. The dispute submitted to the domestic arbitration under the lease agreements was different from the dispute brought to arbitration under the ICSID Convention and the BIT.

The most significant question affected by the applicable law concerned the calculation of interest. Egypt contended that the Tribunal, by awarding interest at the rate of 9%, compounded quarterly, had failed to apply the proper law. Egypt contended that such a calculation of interest was contrary to Egyptian law, specifically Article 226 of the Egyptian Civil Code, which provides for various limits to the determination of interest.¹¹⁸

The *ad hoc* Committee rejected this argument. It found that under the BIT compensation had to be “prompt, adequate and effective” and “compensation shall amount to the market value of the investment expropriated immediately before the expropriation itself.” Although not referring to interest, these provisions had to be read as including a determination of interest that was compatible with those two principles. The *ad hoc* Committee said:

53. The option the Tribunal took was in the view of this Committee within the Tribunal’s power. International law and ICSID practice, unlike the Egyptian Civil Code, offer a variety of alternatives that are compatible with those objectives. These alternatives include the compounding of interest in some cases.¹¹⁹ Whether among the many alternatives available under such practice the Tribunal chose the most appropriate in the circumstances of the case is not for this Committee to say as such matter belongs to the merits of the decision. Moreover, this is a discretionary decision of the Tribunal. Even if it were established that the Tribunal did not rely on the appropriate criteria this in itself would not amount to a manifest excess of power leading to annulment.¹²⁰

Therefore, on the issue of interest, the *ad hoc* Committee found that the Tribunal had rightly given precedence to international law since Egyptian law was in conflict with

¹¹⁸ *Ibid.*, at 342.

¹¹⁹ *Atlantic Tritonl v. Guinea*, Award of 21 April 1986, 3 *ICSID Reports* 17, at 33, 43; *Compania del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, Award of 17 February 2000, 15 *ICSID Review—Foreign Investment Law Journal* 169, at 200-202, paras. 96-107 (2000); *Emilio Augustin Maffezini v. The Kingdom of Spain*, Award, 13 November 2000, 16 *ICSID Review—Foreign Investment Law Journal* 248, at 277, para. 96 (2001). (Footnote and footnote text in the original.)

¹²⁰ See *Wena Hotels Ltd v. Arab Republic of Egypt*, Decision on Annulment, *supra* note 112, at 943.

international law on this particular point.

It would seem that the decision not to annul the part of the Award dealing with interest was reached by way of a somewhat generous reconstruction of the Tribunal's decision. A discussion of interest under Egyptian law was clearly called for. But the Tribunal simply based its decision on international law. The *ad hoc* Committee was able to reach its decision not to annul on the basis of its conclusion that a comparison between the two legal systems would have demonstrated a conflict in which case international law would have prevailed anyway. This reasoning is tenable though not entirely satisfactory. The decision not to annul is justifiable on the ground that, even though there was a failure to apply the proper law on a specific point, this failure did not affect the outcome of the Award.

E. *Metalclad v. Mexico: The Wrong Part of the Right Treaty*

The court in the judicial review of the award in *Metalclad v. Mexico*¹²¹ took the Tribunal to task on its interpretation and application of the relevant treaty provisions. In *Metalclad*, the investor obtained a license from the federal government to operate a landfill facility and it had completed construction of the facility, but municipal authorities effectively prevented it from operating the facility.

Metalclad brought a claim under Chapter 11 of the NAFTA dealing with investment.¹²² The Tribunal held that Mexico had violated the provision on treatment in accordance with international law including fair and equitable treatment contained in Article 1105 and on expropriation and compensation contained in Article 1110 of the NAFTA. In doing so, it relied also on NAFTA's principle of transparency as contained in the principles and rules that introduce the Agreement. The Tribunal said:

76. Prominent in the statement of principles and rules that introduces the Agreement is the reference to "transparency" (*NAFTA Article 102(1)*). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed

¹²¹ For a full report of the case see 5 *ICSID Reports* 209.

¹²² Chapter 11 of NAFTA consists of a Section A dealing with substantive standards of protection for investors and Section B dealing with the settlement of investor/State disputes.

with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.¹²³

After examining the relevant facts, the Tribunal reached the following conclusion:

99. Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.¹²⁴

Mexico sought to set aside the Award on the ground that the Tribunal made decisions outside the scope of the submission to arbitration.

The Tribunal had acted under ICSID's Additional Facility. Therefore, the provisions of the ICSID Convention, including those on the annulment by an *ad hoc* committee, did not apply. Since the place of the arbitration had been designated as Vancouver, British Columbia, the Supreme Court of British Columbia was competent for the setting aside proceedings.

Article 1131 of the NAFTA provides that a Chapter 11 tribunal is to decide the issues in dispute in accordance with the NAFTA and applicable rules of international law. The Supreme Court of British Columbia found that the right of an investor to submit a claim against a NAFTA State under Section B of Chapter 11 is limited to alleged breaches of Section A of Chapter 11 and to two Articles contained in Chapter 15.¹²⁵ It does not enable investors to arbitrate claims in respect of other provisions of NAFTA.¹²⁶

The Supreme Court of British Columbia applied the British Columbia International Commercial Arbitration Act. That Act provides that an arbitral award may be set aside if

... the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration.¹²⁷

¹²³ Metalclad Corporation v. United Mexican States, Award, 30 August 2000, 5 *ICSID Reports* 212, at 226 *et seq.*

¹²⁴ *Ibid.*, at 229.

¹²⁵ See Arts. 1116 and 1117 of NAFTA.

¹²⁶ United Mexican States v. Metalclad Corporation, Judicial Review, Supreme Court of British Columbia, 2 May 2001, 5 *ICSID Reports* 236, at 251.

¹²⁷ *Ibid.*, at 248.

The Court found that the Tribunal had

misstated the applicable law to include transparency obligations and then made its decision on the basis of the concept of transparency.

The principle of transparency is implemented through the provisions of Chapter 18, not Chapter 11.

[T]he Tribunal made its decision on the basis of transparency. This was a matter beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11.¹²⁸

It followed that part of the Award had to be set aside.

The strict standard of review adopted by the Supreme Court of British Columbia is reminiscent of the decisions of the *ad hoc* Committees in *Klöckner* and *Amco*. The NAFTA was clearly part of the applicable law together with applicable rules of international law. But arbitration was available only for breaches of the substantive provisions of Chapter 11 (and of two Articles in Chapter 15). The Tribunal had used the concept of transparency merely to elucidate provisions of Chapter 11. Chapter 18 deals with “Publication, Notification and Administration of Laws”.¹²⁹ In fact, the Tribunal did not rely on Chapter 18 but relied on the principle of transparency as contained in the “Objectives” of the Treaty in Article 102(1)¹³⁰ introducing the NAFTA.

The decision of the British Columbia court is difficult to sustain. It is a standard principle of treaty interpretation that the terms of a treaty are to be considered in their context and in the light of the treaty’s object and purpose.¹³¹ The interpretation of a treaty provision with the help of objectives stated in the treaty’s introductory part is entirely legitimate. Even if the Tribunal used Chapter 18 as an aid to interpreting the concept of fair and equitable treatment contained in Chapter 11, it merely examined the provision’s context. The context of a treaty provision includes the treaty’s entire text. Therefore, the *Metalclad* Tribunal, far from misstating the applicable law, had merely applied the normal rules of treaty interpretation.

¹²⁸ *Ibid.*, at 253-254.

¹²⁹ 32 *ILM* 605, 681-682 (1993).

¹³⁰ 32 *ILM* 297 (1993). The Tribunal quoted from Art. 1802.1 in the Award’s chapter on applicable law as part of the context of Chapter 11.

¹³¹ Vienna Convention on the Law of Treaties, Art. 31(1): “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

F. *CME v. The Czech Republic: Refusal to Apply Host State Law*

Despite the growing authority for the dual application of domestic and international law in investment disputes, in *CME v. The Czech Republic* the Tribunal declined to apply the host State's law. In that case, the Claimant was a Dutch company that had invested in the Czech Republic through its shareholding in the locally incorporated company CNTS. The acquisition took place in several steps but eventually CME held 99 per cent of CNTS. CNTS was the operator of the successful television station called TV Nova. The holder of the television license was not CNTS but another company CET 21.

The relationship between the license holder and its partners was governed originally by a contract, the Memorandum of Association and Investment Agreement of 1993 (the "MOA"). This contract was approved by the Media Council, the Czech regulatory authority. After a change of the Czech Media Act, the 1993 MOA was amended in 1996. As a result of this amendment CNTS relinquished its exclusive right to the use of the license, which it held under the 1993 MOA. Instead, it obtained an exclusive right to the use of the know-how of the license. It was later found by the Tribunal that this amendment was the result of coercion exercised by the Media Council on CNTS. The coercion consisted primarily of an administrative law procedure commenced by the Media Council against CNTS for broadcasting without a license.

In 1997 CET 21 and CNTS entered into a service agreement governing CNTS' rights and obligations as an exclusive service provider for the operation of TV Nova. In 1999 a dispute erupted between CNTS and CET 21. It led to the termination by CET 21 of its service agreement with CNTS on the grounds that CNTS had failed to deliver a daily report of broadcasts, which allegedly constituted a material breach of contract. As a consequence, CNTS lost its position as service provider and its income therefrom. CME argued that the Media Council had colluded in destroying CNTS's business.

CNTS sued CET 21 in the courts of the Czech Republic for having terminated the Service Agreement without cause. This litigation was still pending when the international tribunal made its relevant decisions.

CME instituted arbitration against the Czech Republic under the BIT between the Netherlands and the Czech Republic (formerly the Czech and Slovak Federal Republic).¹³² The arbitration was governed by the UNCITRAL Rules. The place of

¹³² CME was indirectly controlled by a US citizen Ronald Lauder. Lauder also pursued a claim based on the same dispute under the US/Czech BIT. The two UNCITRAL arbitrations ran concurrently and the awards were rendered within a few days of one another in September 2001. The two tribunals reached diametrically opposed results on the basis of the same facts and despite very similar provisions in the two BITs. For the Award in *Lauder v. Czech Republic*, 3 September 2001 see <http://www.mfcr.cz/static/Arbitraz/en/FinalAward.doc>.

arbitration was determined to be Stockholm. The parties agreed that the Tribunal should first determine liability. In a second phase, the Tribunal would determine the quantum of damages, if any.

In its Partial Award on liability¹³³ the majority of the Tribunal reached the conclusion that the Czech Republic had violated a number of the BIT's provisions including the obligation not to deprive the investor of its investment, the obligation of fair and equitable treatment, the obligation not to impair investments by unreasonable or discriminatory treatment, the obligation of full security and protection and the obligation to treat investments in conformity with the principles of international law.¹³⁴ Therefore the Respondent was under an obligation to make full reparation for the injury caused by the Media Council's wrongful acts and omissions.

Concerning the applicable law, Article 8(6) of the Netherlands/Czech BIT contains the following provision:

6. The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:

- the law in force of the Contracting Party concerned;
- the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;
- the provisions of special agreements relating to the investment;
- the general principles of international law.

Therefore, the BIT provided for the application of the host State's law as well as international law. In accordance with the practice, set out above, it was to be expected that the Tribunal would examine all relevant issues from the perspective of the law of the Czech Republic and of international law.

The Tribunal proceeded differently. The Partial Award contained no discussion of applicable law and of Article 8(6) of the BIT. The merits of the case were examined exclusively from the perspective of international law, specifically the BIT.¹³⁵ The Tribunal observed on several occasions in its decision that it had no duty to apply the host State's law. The Tribunal said:

The Tribunal is not to decide on the Czech Administrative Law aspects of this question.¹³⁶

¹³³ CME v. The Czech Republic, Partial Award of 13 September 2001. For the full text of the Partial Award see <http://www.mfcr.cz/static/Arbitraz/en/PartialAward.doc>.

¹³⁴ *Ibid.*, at paras. 586-614.

¹³⁵ The part of the Award dealing with the merits of the case is headed: "The Merits of the Claimant's case under the Treaty", *ibid.*, at para. 427.

¹³⁶ CME v. The Czech Republic, Partial Award, *supra* note 133, at para. 467.

The Tribunal need not decide whether the contribution of the “use of the Licence” in 1993 was legally valid under Czech law.¹³⁷

It is not the Tribunal’s role to pass a decision upon the legal protection granted to the foreign investor for its investment under the Czech Civil Law and civil court system.¹³⁸

It is not the task of the Arbitral Tribunal to judge whether these acts [of the Media Council] were in compliance with Czech law and regulations. The only task for this Tribunal is to judge whether the actions and omissions of the Media Council were in compliance with the Treaty [i.e. the BIT].¹³⁹

These statements are in marked contrast to the practice of other tribunals applying provisions on choice of law that combine references to the host State’s domestic law and to international law as set out above.

The Tribunal’s refusal to refer to Czech law was not restricted to general statements. The application of Czech law was called for in a number of contexts, but the Partial Award shows no sign that it was applied or even considered. For example, the Tribunal found that the Media Council in 1996 coerced CME to abandon the legal security for its investment in the Czech Republic.¹⁴⁰ It referred to the actions that it described as coercion as “unlawful pressure”, “unlawful acts” and “(unlawful) situation of coercion”,¹⁴¹ without indicating under which law it found these actions to be unlawful. Nor did it examine whether the Media Council’s actions were lawful or even required under Czech law. In fact, it was in this context that the Tribunal found that it was “not to decide on the Czech Administrative Law aspects of this question.”¹⁴²

The Tribunal’s treatment of the Media Council’s actions immediately prior to the termination of the service agreement in 1999 was similar. In this context too, the Tribunal speaks of an “(unlawful) situation of coercion”,¹⁴³ of “threat”¹⁴⁴ and of “interference by the Media Council in the economic and legal basis of CME’s investment”.¹⁴⁵ Here too, there is no reference to relevant Czech law by which this

¹³⁷ *Ibid.*, at para. 469.

¹³⁸ *Ibid.*, at para. 476.

¹³⁹ *Ibid.*, at para. 590.

¹⁴⁰ *Ibid.*, at paras. 460-538.

¹⁴¹ *Ibid.*, at paras. 515, 516, 518 and 521.

¹⁴² *Ibid.*, at para. 467.

¹⁴³ *Ibid.*, at para. 518.

¹⁴⁴ *Ibid.*, at para. 550.

¹⁴⁵ *Ibid.*, at para. 551. See also paras. 554, 555, 558.

allegedly unlawful threat, act of coercion and interference was to be judged. It is difficult to see how actions of a regulatory authority with the power to impose sanctions can be conclusively evaluated without an examination of the legal parameters governing its actions.

Neither did the Tribunal examine the consequences of coercion under Czech law. Under Czech law a contract obtained under coercion is null and void. In other words, even if the Tribunal's finding of coercion was correct, under Czech law this would not have had the consequence on the parties' legal relationship that the Tribunal assumed. But the Tribunal never examined this question from the perspective of Czech law. In fact, it explicitly rejected the relevance of Czech civil law for purposes of its analysis.¹⁴⁶

Similarly, the Tribunal addressed the legal significance of the changes in the contractual arrangements, allegedly brought about by the "coercion", without reference to Czech law. It found that the changes in the contractual arrangements between CNTS and CET 21 substantially weakened the investor's legal situation.¹⁴⁷ In particular, it held that these changes "vitiating the Claimant's protection",¹⁴⁸ "undermine the legal protection of CME's investment",¹⁴⁹ that the changes were "dismantling the legal basis of the foreign investor's investments",¹⁵⁰ that "CME lost its legal protection for the investment",¹⁵¹ that the changes resulted in a "coerced vitiating of CME's basis for its investment"¹⁵² and led to "giving up legal security for CME's investment",¹⁵³ that it did "destroy the legal basis (the safety net) of the foreign investor's investment",¹⁵⁴ "jeopardized the legal basis of CME's investment",¹⁵⁵ "deprived the Claimant of its investment's security"¹⁵⁶ and led "to the elimination of basic rights for the protection of its investment".¹⁵⁷

¹⁴⁶ *Ibid.*, at para. 476.

¹⁴⁷ *Ibid.*, at paras. 471, 473, 475, 531, 573, 595, 598.

¹⁴⁸ *Ibid.*, at para. 469.

¹⁴⁹ *Ibid.*, at para. 480.

¹⁵⁰ *Ibid.*, at para. 520.

¹⁵¹ *Ibid.*, at para. 527.

¹⁵² *Ibid.*, at para. 533.

¹⁵³ *Ibid.*, at para. 538.

¹⁵⁴ *Ibid.*, at para. 554.

¹⁵⁵ *Ibid.*, at para. 574.

¹⁵⁶ *Ibid.*, at para. 599.

¹⁵⁷ *Ibid.*, at para. 603.

It is clear that the contract between CNTS and CET 21 was governed by Czech law. It follows that any such fundamental change in the contractual relationship between the two business partners was governed by Czech law. But none of the Tribunal's numerous assessments of the alleged legal change to the detriment of the investor was supported by reference to Czech civil, commercial or corporate law.

The termination of the Service Agreement by CET 21 led to a lawsuit by CNTS against CET 21 in the courts of the Czech Republic. The Regional Commercial Court in Prague on May 4, 2000 judged the termination void. On appeal, the Court of Appeal on 14 December 2000 confirmed the validity of the termination. Upon further appeal, the Czech Supreme Court on 14 November 2001 vacated the decision of the Court of Appeal and remanded the case. This was the situation at the time the Tribunal rendered its Partial Award.

The Tribunal adopted a dismissive attitude towards these proceedings. The outcome of the court proceedings was described as irrelevant¹⁵⁸ and "not dispositive".¹⁵⁹ The Court of Appeal was criticized for having "inadequately dealt with the facts and circumstances"¹⁶⁰ in "a highly unconvincing judgment".¹⁶¹ No reasons were given for this harsh criticism. The fact that the decision of the court of first instance was overturned by the Court of Appeal which in turn was vacated by the Supreme Court, in the Tribunal's view, demonstrated a legal uncertainty through "contradictory Civil Court judgments"¹⁶² or "differing court decisions".¹⁶³ The nature of the Czech court decisions, in the Tribunal's eyes, "clearly shows how fragile the Claimant's investment is".¹⁶⁴ The investment "was put at the risk of civil court decisions".¹⁶⁵ The arrangement could easily be jeopardized again by "dragging CNTS into Civil Court proceedings".¹⁶⁶ The court proceedings exposed the investor to the "unacceptable legal and commercial risk of prolonged legal battles".¹⁶⁷ The Court of Appeal's judgment was seen as "a clear proof of the fragile character of the (coerced) 1996 amendment."¹⁶⁸

¹⁵⁸ *Ibid.*, at paras. 416, 522, 525, 575.

¹⁵⁹ *Ibid.*, at para. 530.

¹⁶⁰ *Ibid.*, at para. 477.

¹⁶¹ *Ibid.*, at para. 532.

¹⁶² *Ibid.*, at paras. 414, 598.

¹⁶³ *Ibid.*, at para. 598.

¹⁶⁴ *Ibid.*, at para. 414.

¹⁶⁵ *Ibid.*, at para. 474.

¹⁶⁶ *Ibid.*, at para. 475.

¹⁶⁷ *Ibid.*, at para. 532.

¹⁶⁸ *Ibid.*, at para. 597.

For the Tribunal, the mere fact that the investor had to resort to the courts of the Czech Republic in a dispute with its business partner was proof that the legal arrangements between CNTS and CET 21, allegedly coerced upon the investor, were unsatisfactory. The system of appeal in the hierarchy of domestic courts was seen as constituting an unacceptable risk to the investor. No denial of justice or other impropriety by the courts of the Czech Republic was alleged. Rather, it appears that the Tribunal found that the need to resort to domestic courts in a dispute with a business partner in itself was enough to violate the investor's rights regardless of the outcome of these court proceedings.

Under the UNCITRAL Arbitration Rules a tribunal may decide *ex aequo et bono* only if so authorized by the parties.¹⁶⁹ No such authorization existed in the instant case. There is no doubt that the Tribunal applied the BIT and some international law authorities¹⁷⁰ to the facts before it. Therefore, it would be incorrect to state in general terms that the Partial Award was based on equity instead of law. But certain passages of the Partial Award create the impression that the arbitrators felt that they were not bound by positive law but were performing the role of *amiable compositeurs* deciding *ex aequo et bono*. This impression is created not only by the explicit disavowal of Czech law, as outlined above, but also by a number of conclusions on issues of tort, contract and criminal law which are difficult to perceive as an application of international law.

The Tribunal repeatedly passed judgment on the parties' activities without offering a legal basis. It referred to matters being unacceptable.¹⁷¹ It denied that the Media Council's actions were "part of proper administrative proceedings"¹⁷² without reference to Czech administrative law or, for that matter, any administrative law. Similarly, the activities of CET 21's manager were characterized as an "unconcealed violation ... of his duties under corporate and civil law", which the Tribunal described as "a breach of law that must be assessed as a serious criminal offence in any functioning judicial system".¹⁷³ These statements were made without any references to Czech or any other system of law.

¹⁶⁹ UNCITRAL Arbitration Rule 33(2): The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration. Available at <http://www.uncitral.org/en-index.htm>.

¹⁷⁰ *CME v. The Czech Republic*, Partial Award, *supra* note 133, at paras. 398, 517, 526, 580, 583, 584.

¹⁷¹ *Ibid.*, at paras. 475, 532.

¹⁷² *Ibid.*, at para. 603.

¹⁷³ *Ibid.*, at para 552.

After the Partial Award had been rendered, the Czech Republic requested consultations with the Netherlands on the interpretation and application of the BIT. These consultations led to Agreed Minutes signed on 17 June 2002. With respect to the provision on applicable law in the BIT the Agreed Minutes state:

2. On the issue of investment disputes and interpretation of Article 8.6 of the Agreement

The delegations agree that the arbitral tribunal shall decide on the basis of the law. When making its decision, the arbitral tribunal shall take into account, in particular, though not exclusively, the four sources of law set out in Article 8.6. The arbitral tribunal must therefore take into account as far as they are relevant to the dispute the law in force of the Contracting Party concerned and the other sources of law set out in Article 8.6. To the extent that there is a conflict between national law and international law, the arbitral tribunal shall apply international law.

Therefore, the two governments made it clear that a Tribunal must take the host State's law into account to the extent that it is relevant to the dispute.

The Czech Republic instituted proceedings for a declaration of invalidity or the setting aside of the Partial Award in accordance with the Swedish Arbitration Act. The Act's Section 34(2) provides that an arbitral award shall be set aside "where the arbitrators have ... exceeded their mandate". Failure to take into consideration the applicable law was one of several grounds invoked for the Partial Award's setting aside.¹⁷⁴ The Czech Republic argued that the Tribunal had failed to apply Czech law in violation of Article 8(6) of the BIT. The Republic pointed out that Czech law was relevant on a number of issues and was argued in detail before the Tribunal. In particular, the Republic argued that the Tribunal's conclusions concerning the contractual relationship between CNTS and CET 21 and the effect of the alleged coercion upon them were impossible to make without an investigation of *inter alia* Czech company law and contract law. As for the activities of the Media Council, the legality of these should have been examined first of all under Czech administrative law.¹⁷⁵

¹⁷⁴ Other grounds were the charge that the dissenting arbitrator had been excluded from parts of the Tribunal's deliberations, the principles of *lis pendens* and *res judicata* in relation to the parallel arbitration proceedings in *Lauder v. Czech Republic* (see *supra* note 132), the Tribunal's decision on a point that was not canvassed in argument and the examination by the Tribunal of issues concerning the amount of damages which had been relegated to the second part of the proceedings.

¹⁷⁵ The Czech Republic's submission was accompanied by a legal opinion prepared by the author of this article and by Professor August Reinisch. The text of the opinion is available at http://www.univie.ac.at/intlaw/pdf/cmeopin_1.pdf. An adapted version of the opinion

While the proceedings for the setting aside of the Partial Award were pending before the Swedish court, the Tribunal rendered its Final Award.¹⁷⁶ In contrast to the Partial Award, the Tribunal's analysis in the Final Award begins with a chapter entitled "The Law Applicable to this Arbitration".¹⁷⁷ That chapter is devoted almost entirely to a defence of the Partial Award against the charge of not having applied the governing law.

The Tribunal explains its non-application of Czech law by stating that Czech law was never pleaded before it in the First Phase leading to the Partial Award¹⁷⁸ and that a tribunal was not bound to research find and apply national law that had not been argued or referred to by the parties.¹⁷⁹

The Tribunal's central explanation for declining to apply Czech law was its interpretation of Article 8(6) of the Czech/Netherlands BIT. It found that this provision gave broad discretion and that, under its wording, the Tribunal was bound merely to

was submitted to the Tribunal and is available at http://www.univie.ac.at/intlaw/pdf/cmequant_2.pdf.

¹⁷⁶ *CME v. The Czech Republic*, Final Award, 14 March 2003. For the text of the Final Award see http://www.cetv-net.com/iFiles/1439-Final_Award_Quantum.pdf.

¹⁷⁷ *Ibid.*, at paras. 396-413.

¹⁷⁸ *Ibid.*, at para. 400. This statement is not supported by the text of the Partial Award. The Partial Award contains summaries of the Parties' positions and arguments that demonstrate reliance by the Respondent on Czech law. In particular, there was extensive reliance on the Czech Media Law (paras. 182-188, 194, 196, 199-201, 212, 219, 235, 239, 241, 254, 255, 257, 276, 315, 338, 341, 347, 355, 365, 366 and 367) and on other areas of Czech law, including contract law, administrative law and Czech law in general (paras. 196, 200, 219, 276, 312, 313, 345, 347 and 371). In addition, the repeated statements by the Tribunal in the Partial Award that it was not its task to apply Czech law (paras. 467, 469, 476, 590) can only be understood in the context of the invocation of Czech law by one of the parties.

¹⁷⁹ *Ibid.*, at para. 411. By contrast, other international tribunals, applying the principle of *iura novit curia*, have refused to be confined in their application of the relevant law to the pleadings of the parties. ICSID *ad hoc* Committees hearing annulment cases have uniformly rejected the idea that tribunals in drafting their awards were restricted to the legal arguments presented to them by the parties. They held that tribunals committed no procedural error in relying on legal authorities that had not been put forward by the parties. See *Klöckner v. Cameroon*, Decision on Annulment, 2 *ICSID Reports* 128-129; *MINE v. Guinea*, Decision on Annulment, 4 *ICSID Reports* 82, at 106, 109; *Wena Hotels v. Egypt*, Decision on Annulment, 41 *ILM* 933, at para. 70 (2002); *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic (the Vivendi case)*, Decision on Annulment, 41 *ILM* 1135, at paras. 82-85 (2002).

take the four sources into account and not to apply them.¹⁸⁰ The Tribunal's basic mandate was simply

to “*decide on the basis of law*”, which is a self-explanatory confirmation of the basic principle of law to be applied in international arbitration according to which the arbitral tribunal is not allowed to decide *ex aequo et bono* without authorization by the parties [...].¹⁸¹

A reading of Article 8(6) of the BIT would suggest that the Tribunal's discretion related to the application of additional sources rather than to disregarding some of the sources listed there. If the Tribunal really had discretion to apply some (or one) of the sources listed in Article 8(6) but to disregard others it would also have the discretion to disregard the BIT itself—an obviously unsatisfactory result.

The Tribunal appeared to think that the only real obligation arising from Article 8(6) of the BIT was to “decide on the basis of the law”¹⁸²—any law—rather than on the basis of equity. However, this interpretation would render Article 8(6) of the BIT meaningless. A restatement of this principle in the BIT was superfluous. Moreover, it leads to the inevitable conclusion that the parties had not designated the applicable law and that, therefore, in accordance with Article 33(1) of the UNCITRAL Rules, the Tribunal had discretion to apply the conflict of laws rules that it considered applicable.

This result, in turn, is at odds with the Tribunal's own introductory statement to its analysis of applicable law in the Final Award:

396. In respect of the law applicable to the merits of this arbitration dispute, the Tribunal is bound by provisions of Article 8(6) of the Treaty [...].¹⁸³

The Tribunal rejected precedents such as *Fedax v. Venezuela*, *Maffezini v. Spain* and *Goetz v. Burundi* in which tribunals applied choice of law clauses in other BITs.¹⁸⁴ In these cases the tribunals reached the conclusion that host State law had to be applied. The similarity of the choice of law clauses in the BITs in these cases to Article 8(6) of the Czech/Netherlands BIT is evident. The Tribunal dismissed these cases stating that the choice of law clauses applicable in these cases are significantly different and

¹⁸⁰ *Ibid.*, at para. 402. Curiously, elsewhere the Tribunal speaks of “the application of the four sources of law as provided for in Art. 8(6) of the Treaty”. *Ibid.*, at para. 400.

¹⁸¹ *Ibid.*, at para. 403. The emphases are the Tribunal's.

¹⁸² *Ibid.*, at paras. 402, 403, 406.

¹⁸³ *Ibid.*, at para. 396.

¹⁸⁴ See the analysis of these cases above at notes 15-25.

do not mirror the broad choice of law clause in Article 8(6) of the BIT.¹⁸⁵ While all four choice of law clauses show variations in language, it is difficult to see any peculiarity of Article 8(6) of the Czech/Netherlands BIT that would set it apart from the clauses that were applied in the other three cases.

The Tribunal specifically rejected the idea that in arbitration under a bilateral investment treaty, local remedies had to be exhausted.¹⁸⁶ This statement is no doubt correct. But the role of the Czech courts arose in a different context. The case before the Tribunal turned on the preliminary question of whether the MOA between CNTS and CET 21 had been amended under coercion to the investor's detriment and whether the service contract had been terminated validly. In such a situation is it possible to disregard the applicable Czech substantive law and to dismiss domestic court proceedings that deal with this question as irrelevant? This point is quite different from a requirement to exhaust local remedies. Exhaustion of local remedies would mean that the main claim between CME and the Czech Republic had to be pursued first through the Czech courts before it can be pursued through international arbitration. No such suggestion was ever made.

After having defended its Partial Award against the charge of non-application of the proper law, specifically the non-application of Czech law, the Tribunal proceeded to deal with the merits before it. In doing so, the Tribunal in the Final Award shows a treatment of Czech law that is markedly different from the Partial Award. Whereas the Partial Award explicitly disavowed Czech law, the Final Award contains detailed references to and discussion of Czech civil law.

The Final Award contains a discussion of coercion under Czech civil law including an analysis of Articles 37 and 49 of the Czech Civil Code and of Article 267(2) of the Czech Commercial Code.¹⁸⁷ In addition, there is a discussion of Article 438 of the Czech Civil Code dealing with joint tortfeasors.¹⁸⁸

In calculating damages, the Tribunal refers to Article 443 of the Czech Civil Code to determine the relevant time for the assessment of the amount of damages.¹⁸⁹ There is also a detailed discussion of the applicable law to the issue of valuation. This discussion relies not only on the BIT but also on Article 25(3) of the Czech Commercial Code and on Articles 23 and 34 of the Czech Valuation Act.¹⁹⁰

¹⁸⁵ CME v. The Czech Republic, Final Award, *supra* note 176, at paras. 402, 409.

¹⁸⁶ *Ibid.*, at paras. 398, 412, 413.

¹⁸⁷ *Ibid.*, at para. 486.

¹⁸⁸ *Ibid.*, at para. 452.

¹⁸⁹ *Ibid.*, at para. 492.

¹⁹⁰ *Ibid.*, at paras. 503-507.

The Tribunal's discussion of interest is introduced by the statement: "In awarding interest in respect of the rate and period, the Tribunal has considered the provisions of the Treaty (...), Czech law and international law principles (...)." ¹⁹¹ It relies on Article 517 of the Czech Civil Code and a related Government Decree of 1994 in relation to interest on late payments. ¹⁹² After stating that in determining the period of interest it took into account Czech law, the Tribunal proceeds to rely on Article 563 of the Czech Civil Code, on a legal opinion of the Czech Supreme Court and on a scholarly publication on the Czech Civil Code. ¹⁹³ Concerning the rate of interest, the Tribunal first states that neither the BIT nor international law contains a pertinent rule. It then applies the provisions of Czech law contained in Article 517 of the Czech Civil Code and the Government Decree of 1994. The latter Decree is discussed in some detail and even quoted in the Czech language. ¹⁹⁴ Finally, the Tribunal relies on Article 369 of the Czech Commercial Code and on the Government Decree for the question of simple or compound interest. ¹⁹⁵

In allocating costs between the parties, the Tribunal relies on Article 142(2) of the Czech Civil Procedure Code. ¹⁹⁶

This detailed reliance on Czech law in the Final Award is in clear contrast to the Partial Award.

The judgment of the Svea Court of Appeal on the application to declare invalid or set aside the Partial Award ¹⁹⁷ was rendered two months after the Tribunal's Final Award. The Court denied the application of the Czech Republic. It prefaced its reasons by a statement that the Swedish Arbitration Act was based on a restrictive approach towards having an arbitration award declared invalid or set aside. Annulment should be possible only in exceptional circumstances. ¹⁹⁸

The Court's treatment of the "failure to take into consideration applicable law" was brief. ¹⁹⁹ The Court stated that the parties may agree on the law of a particular

¹⁹¹ *Ibid.*, at para. 627.

¹⁹² *Ibid.*, at para. 629.

¹⁹³ *Ibid.*, at paras. 631-632.

¹⁹⁴ *Ibid.*, at paras. 637-641.

¹⁹⁵ *Ibid.*, at para. 642.

¹⁹⁶ *Ibid.*, at para. 648.

¹⁹⁷ *The Czech Republic v. CME Czech Republic B. V.*, Svea Court of Appeal, 15 May 2003. For an English translation see 42 *ILM* 919 (2003). See also http://www.mfcr.cz/static/Arbitraz/en/Judgment_English.doc.

¹⁹⁸ *Ibid.*, at 960-961

¹⁹⁹ *Ibid.*, at 963-965.

country and that where the arbitrators have applied the law of a different country in violation of such an agreement the award may be set aside on the ground that the arbitrators have exceeded their mandate. The Arbitration Act sought to reduce the possibilities to challenge an arbitration award on the ground that the arbitrators have applied the wrong law. There was no excess of mandate where the arbitrators had applied the designated law incorrectly. Nor would there be an excess of mandate if the arbitrators had interpreted a designation of the applicable law incorrectly.²⁰⁰ In the opinion of the Court, an excess of powers would occur only where the arbitrators have almost ignored a provision regarding applicable law.²⁰¹

After quoting Article 8(6) of the BIT, the Court said:

[T]he contracting states have left to the arbitrators the determination, on a case by case basis, as to which source or sources of law shall be applied.

[T]he clause leaves to the arbitral tribunal to take into account Czech law and other sources of law insofar as such are relevant in the dispute. ... In the Court of Appeal's opinion, when assessing whether the arbitrators have exceeded their mandate, it is sufficient to clarify whether the arbitral tribunal applied any of the sources of law listed in the choice of law clause or whether the tribunal has not based its decision on any law at all but, rather, judged in accordance with general reasonableness.²⁰²

The Court's reasoning adopted the theory of complete discretion of the Tribunal in selecting the applicable rules among the sources listed in Article 8(6) of the BIT. That list of sources is so comprehensive that it is difficult to imagine that a tribunal could ever go outside it. More importantly, in the Court's view, the discretion included the power not to apply some of the sources listed in Article 8(6). Therefore, the Court accepted the Tribunal's theory that it was in compliance with its duty to apply the governing law as long as it applied any law at all and did not judge in accordance with general reasonableness. This would only have been the case if the Tribunal's decision had been devoid of any basis in law. The Court was not going to investigate whether certain issues should have been decided under Czech law.

The Partial Award in *CME v. The Czech Republic* was a clear cut case of a failure to apply at least part of the governing law. One need not look further than the Final Award for an illustration of how the Tribunal should have proceeded in the first place. A healthy environment for foreign investment depends upon striking the right balance between maintaining the integrity of the regulatory framework of the host State and

²⁰⁰ *Ibid.*, at 963-964.

²⁰¹ *Ibid.*, at 964.

²⁰² *Ibid.*, at 965.

protecting the investor from arbitrary interference. The dual reference to host-State law and to international law does this. There is no question that any application of host-State law to investment disputes must be subject to international standards, but this does not mean that host-State law can be disregarded entirely.

Appropriate respect for local regulation is of critical importance to securing the welcome needed by foreign investors. The kind of disregard that the CME Tribunal showed in its Partial Award to Czech law and to Czech proceedings is likely to cause alarm in host States dealing with foreign investors. These States are unlikely to react with equanimity when told by a tribunal that their legal system is irrelevant in an investment dispute. Decisions of this nature may contribute to a backlash by capital importing countries against the protection of foreign investments by treaties and through international arbitration.

The decision of the Swedish court refusing to set aside the Partial Award is regrettable but hardly surprising. It reflects a trend by domestic courts to annul arbitral awards only under the most extreme circumstances. A decision to set aside would have required an analysis of which issues before the Tribunal required the application of Czech law, a task that the Svea Court was evidently unwilling to undertake. The Court was satisfied with the observation that the Tribunal had somehow remained within the wide parameters of the clause on applicable law in Article 8(6) of the BIT. The Court was not going to investigate whether the Tribunal had erred in selecting or ignoring the specific sources listed there. In view of the all-encompassing nature of the BIT's provision on applicable law that was a minimalist standard for review.

IV. Conclusions

The picture emerging from this survey is quite heterogeneous. The decisions range from overzealous annulments for trivial reasons (*Klöckner, Metalclad*), at one end of the spectrum to a refusal to annul despite a clear and explicit non-application of part of the governing law (*CME*) at the other end. No distinguishing features in the rules defining the applicable law or in the terms of reference of the reviewing organs can be made out.

The simple statement that a non-application of the governing law is a ground for annulment, whereas an error in applying the governing law is not, is of limited use. The examples, set out above, show how different the situations were in which decisions had to be made whether an alleged failure to apply the governing law warranted annulment. In *Klöckner* the Tribunal had selected the applicable law correctly but had failed to substantiate a particular principle that it applied. In *Amco* the Tribunal had also selected the applicable law correctly but had failed to apply a particular provision of that law. In *MINE* the Tribunal had merely erred in stating the name of the national code that it applied. In *Metalclad* the Tribunal had identified the

applicable treaty correctly but had considered other parts of that treaty for the purpose of interpreting the applicable rules. In all these cases there was no error in identifying the applicable law though possibly mistakes in its application.

In *Wena* the Tribunal had also identified the applicable law correctly as domestic law and international law. But on the point of interest it relied on international law only. That decision was upheld in the annulment proceedings essentially because a concurrent application of both legal systems would have led to the same result namely the prevalence of international law.

In *CME* the Tribunal in the Partial Award did not identify the applicable law correctly. Domestic law and international law were applicable but the Tribunal rejected the reliance on domestic law and applied international law only. The Tribunal did not decide outside the provision on applicable law but declined to apply an essential part of it. Issues of administrative law and of civil law (contract and torts) constituted decisive preliminary questions for reaching a correct result under the BIT.

In case of a combined choice of law it cannot suffice for a reviewing organ to find that one or the other element of the applicable law was in fact applied. It is necessary also to determine which legal questions were to be determined by what legal system. Otherwise the existence of a broad clause on applicable law, combining domestic and international law, would deprive the process of review for failure to apply the governing law of any meaning. This requires that the reviewing organ engages in a minimum examination of the various substantive issues for the purpose of determining which law should have been applied to them. But this is where the review for excess of powers must stop. It is not its task to examine whether the correctly selected law was correctly applied.

The Swedish court in *CME* declined to undertake this minimum examination. By confining itself to a finding that the Tribunal had remained within the all-encompassing framework of the BIT's clause on applicable law it deprived the concept of a review for failure to apply the governing law of any practical consequence.

