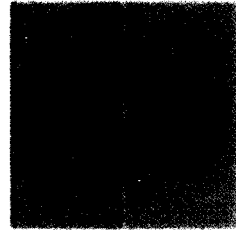


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The Extent of Review of the Applicable Law in Investment Treaty Arbitration

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The considerable increase in the number of arbitral proceedings initiated on the basis of investment treaties is one of the most striking features of ICSID arbitration today. In 1993, a single new case was registered by the Centre on the basis of a bilateral investment treaty (“BIT”). In 1997, out of ten new cases, five were based on BITs, and five on an arbitration agreement contained in a contract. In 2002, sixteen out of nineteen new cases were based on a BIT. In 2003, interestingly, all of the thirty new cases were based on BITs.

This evolution has affected ICSID arbitration in a spectacular way, both in terms of the jurisdiction of the Centre and the law applicable to the investment dispute. As regards jurisdiction, it will often be the case that an investor has entered into a contract with the host State whereby the parties have provided that the local courts have exclusive jurisdiction over disputes arising from the performance of the contract. In such cases, the jurisdiction of the local courts based on the contract may coexist with the jurisdiction of an ICSID tribunal constituted pursuant to the applicable BIT,¹ although the nature of this

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¹ On novel issues such as the jurisdictional distinction between contractual claims and treaty claims, see Bernardo M. Cremades, *Litigating*

coexistence has been the subject of differing interpretations in recent ICSID cases such as *Salini v. Morocco*, *SGS v. Pakistan*, and *SGS v. Philippines*.²

The treaty nature of the commitments made by host States towards investors also raises the issue of the law applicable to investment disputes. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States of March 18, 1965 (the “Washington Convention”) provides for choice of law rules. Under Article 42(1) of the Washington Convention, the law applicable to the substance of the dispute is determined by the parties and, in the absence of such choice, by the arbitral tribunal:

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.

Annulment Proceedings. The Vivendi Matter: Contract and Treaty Claims, *supra* at 87; see also Emmanuel Gaillard, *L'arbitrage sur le fondement des traités de protection des investissements*, 2003 REVUE DE L'ARBITRAGE [REV. ARB.] 853.

² *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, Decision on jurisdiction, July 23, 2001, 42 I.L.M. 609 (2003); *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, Decision on objections to jurisdiction, Aug. 6, 2003, 18 ICSID REV. – FOREIGN INV. L.J. 307 (2003); *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, Decision on objections to jurisdiction, Jan. 29, 2004, available on the ICSID website. See the commentaries of these decisions in EMMANUEL GAILLARD, *LA JURISPRUDENCE DU CIRDI* (2004). See also Gabrielle Kaufmann-Kohler, *Annulment of ICSID Awards in Contract and Treaty Arbitrations: Are there Differences?*, *supra* at 189.

In accordance with these principles, the applicable law in treaty arbitration must be determined by reference to the provisions of the relevant treaty (I). In the absence of any such provisions, the dispute is to be resolved pursuant to the choice of law process contained in the second sentence of Article 42(1) of the Washington Convention. The issue is then whether international law plays a particular role in treaty arbitration in light of the fact that the disputes between an investor and the host State under an investment treaty deals with the international responsibility of the State (II). In this respect, recent ICSID case law has recognized the great degree of freedom that arbitral tribunals have to determine the applicable rules of law in a particular dispute and, correspondingly, the restrictions upon any review by an *ad hoc* committee pursuant to the manifest excess of powers standard of Article 52 of the Washington Convention of an award rendered on such basis (III).

I. THE DETERMINATION OF THE APPLICABLE LAW IN TREATY ARBITRATION IS SUBJECT TO THE PROVISIONS OF THE RELEVANT TREATY

In treaty arbitration, the arbitral tribunal is called upon to determine whether a State has acted in a manner consistent with its international obligations under the treaty relied upon by the investor. The investor and the host State—or the State entity—may have entered into a contract underlying the investment, referring the parties to the local courts and providing for the applicability of the law of the host State. Under the applicable treaty, however, the issue is whether the State has fulfilled its international treaty obligations to protect that investment. The relationship under consideration is between the investor and the host State under that treaty as opposed to the relationship between the investor and the host State—or the State entity—under the contract. The dissociation between the contractual relationship and

the treaty relationship was clearly adverted to by the *ad hoc* Committees constituted in *Wena v. Egypt* and *Vivendi v. Argentina*,³ in relation to issues of choice of law and choice of jurisdiction, respectively. As a result, because the treaty is the basis for the tribunal's jurisdiction, the focal point is whether there is a choice of law provision in the treaty itself.

Certain investment treaties—concluded either on a bilateral or on a multilateral basis, such as the North American Free Trade Agreement or the Energy Charter Treaty—provide for the law applicable to the substance of the dispute between one of the contracting States and the national of the other contracting State(s). The choice of law clauses contained in such treaties may be categorized as follows. In almost every case, the dispute between the investor and the host State is to be decided “in accordance with the provisions of the Agreement” itself.⁴ Frequently, the treaty is applicable in conjunction with “the principles of international law”⁵ or “the applicable rules of international law.”⁶ The choice

³ *Wena Hotels Limited v. Arab Republic of Egypt*, Decision on application for annulment, Feb. 5, 2002, 41 I.L.M. 933 (2002), reproduced in this volume at Annex 2; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, Decision on application for annulment, July 3, 2002, 41 I.L.M. 1135 (2002), reproduced in this volume at Annex 4.

⁴ *See, e.g.*, the BITs entered into between Argentina and Egypt, between Canada and Thailand, or between China and Kuwait.

⁵ *See, e.g.*, the BITs entered into between Belgium & Luxembourg and Cyprus or between Panama and Uruguay.

⁶ *See, e.g.*, the BITs entered into between Canada and Ecuador, between Mexico and the Netherlands, or between Italy and Venezuela. *See also* Article 1131(1) of the North American Free Trade Agreement (NAFTA) entered into force on January 1, 1994: “[a] Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law;” Article 26(6) of the Energy Charter Treaty entered into force on April 16, 1998 in turn provides that “[a] Tribunal established under

of law may also include the law of the host State,⁷ although some BITs have internationalized the investment relationship to the extent that they refer only to the treaty itself and to the applicable rules of international law.⁸ Conversely, some BITs refer to the treaty itself, the law of the host State and particular agreements between the parties, but not to the rules of international law.⁹

When the treaty itself provides for the law applicable to the substance of the investment dispute, the investor's acceptance—expressed in the submission of the request for arbitration—of the general offer made by the State in the treaty constitutes the agreement between the disputing parties set forth in the first sentence of Article 42(1). In other words, the choice of law clause contained in the treaty operates as the law chosen by the disputing parties regardless of the fact that, in an investment dispute, the expression of each of the disputing parties' consent is dissociated in time.¹⁰ As a result, an arbitral tribunal constituted on the basis of such a treaty has the duty to respect the choice of law validly

paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.”

⁷ See, e.g., the BITs entered into between Chile and Costa Rica, or between China and Egypt.

⁸ In addition to the NAFTA and the Energy Charter Treaty (*supra* note 6), most of the BITs entered into by Canada fall within this category (with the exception of the BITs between Canada and Argentina and between Canada and Costa Rica which refer also to the law of the host State; in the latter case, the law of the host State applies only insofar as it is not inconsistent with the BIT or the principles of international law); see also the BITs entered into between Mexico and Spain or between France and Poland.

⁹ See, e.g., the BIT entered into between Australia and Egypt, or between Belgium & Luxembourg and Mongolia.

¹⁰ On this issue, see WALID BEN HAMIDA, L'ARBITRAGE TRANSNATIONAL UNILATÉRAL. RÉFLEXIONS SUR UNE PROCÉDURE RÉSERVÉE À L'INITIATIVE D'UNE PERSONNE PRIVÉE CONTRE UNE PERSONNE PUBLIQUE (2004).

made by the disputing parties pursuant to the first sentence of Article 42(1) of the Washington Convention.

Situations in which the law is chosen by the disputing parties—albeit in a dissociated manner—on the basis of the choice of law provision of a treaty are not, however, the most common type of occurrence. A very large number of treaties, in particular BITs, do not provide for any choice of law.¹¹

II. IN THE ABSENCE OF CHOICE OF LAW PROVISIONS IN THE RELEVANT TREATY, THE DETERMINATION OF THE APPLICABLE LAW IS SUBJECT TO THE INTERPRETATION OF THE SECOND SENTENCE OF ARTICLE 42(1) OF THE WASHINGTON CONVENTION

In the absence of a provision on the applicable law in an investment treaty, there is, by definition, no prior agreement on the applicable law between the parties to an ICSID arbitration. In this context, the second sentence of Article 42(1) gains considerable importance. Unless the parties to the arbitration unequivocally agree otherwise during the course of the proceedings, the law applicable to the merits of the dispute is to be determined in accordance with the choice of law rule contained in that provision.

The choice of law rule in the second sentence of Article 42(1) contains two components: in the absence of an agreement between the parties, the tribunal shall apply “the law of the Contracting State party to the dispute (including its rules on the

¹¹ For example, the majority of the BITs entered into by countries such as the United States, the United Kingdom, France or Germany do not contain a clause on the applicable law regarding investment disputes between one of the contracting States and the investors of the other contracting State.

conflict of laws) *and* such rules of international law as may be applicable.”

Significantly, it is worth pointing out that, in treaty arbitration, whether or not a choice of law provision is contained in the investment treaty itself, international law plays an important role in the assessment of the substance of the dispute: either the treaty itself refers to international law as the set of applicable rules or international law comes into play pursuant to the choice of law rule set forth in Article 42. In the latter case, the determining issue is the meaning that should be attributed to the word “and” and how a specific arbitral tribunal should apply each of international law and the law of the host State in accordance with the second sentence of Article 42(1).¹²

The issue was raised, and settled, in the early days of ICSID case law—although in relation to arbitrations initiated on the basis of an arbitration clause contained in a contract—when the awards rendered by the arbitral tribunals in the notorious cases of *Klöckner v. Cameroon*¹³ and *Amco v. Indonesia*¹⁴ were submitted to the review of two *ad hoc* Committees on the ground of a manifest excess of powers with respect to the application of the principles of international law. Both *ad hoc* Committees held that international law could only come into play in the second sentence of Article 42(1) if the law of the host State contained gaps or in the

¹² On this issue, see Emmanuel Gaillard and Yas 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 REV.–FOREIGN INV. L.J. 375 (2003).

¹³ *Klöckner Industrie-Anlagen GmbH and others v. Republic of Cameroon and Société Camerounaise des Engrais*, Decision annulling the award, May 3, 1985, 2 ICSID REP. 95 (1994).

¹⁴ *Amco Asia Corporation and others v. Republic of Indonesia*, Decision annulling the award, May 16, 1986, 1 ICSID REP. 509 (1993).

case of a collision between the two sets of norms. The *ad hoc* Committee constituted in *Klöckner* held that:

Article 42 of the Washington Convention certainly provides that “in the absence of agreement between the parties, the Tribunal shall apply the law of the Contracting State party to the dispute... and such principles of international law as may be applicable.” This gives these principles (perhaps omitting cases in which it should be ascertained whether the domestic law conforms to international law) a dual role, that is, *complementary* (in the case of a “lacuna” in the law of the State), or *corrective, should the State’s law not conform on all points to the principles of international law*. In both cases, the arbitrators may have recourse to the “principles of international law” *only after having inquired into and established* the content of the law of the State party to the dispute (which cannot be reduced to one principle, even a basic one) and *after having applied* the relevant rule 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.”*¹⁵

The same rationale was adopted by the *ad hoc* Committee constituted in *Amco*, which held that:

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*.

¹⁵ Klöckner v. Cameroon, *supra* note 13, ¶ 70 at 122 (emphasis added).

The above view of the role or relationship of international law norms vis-à-vis the law of the host State, in the context of Article 42(1) of the Convention, is suggested by an overall evaluation of the system established by the Convention. The law of the host State is, in principle, the law to be applied in resolving the dispute. At the same time, applicable norms of international law must be complied with since every ICSID award has to be recognized, and pecuniary obligations imposed by such award enforced, by every Contracting State of the Convention (Art. 54(1), Convention). Moreover, the national State of the investor is precluded from exercising its normal right of diplomatic protection during the pendency of the ICSID proceedings and even after such proceedings, in respect of a Contracting State which complies with the ICSID award (Art. 27, Convention). The thrust of Article 54(1) and of Article 27 of the Convention makes sense only under the supposition that the award involved is not violative of applicable principles and rules of international law.

The above view on the *supplemental and corrective role of international law* in relation to the law of the host State as substantive applicable law, is shared in ICSID case law (Decision of May 3, 1985 of an ICSID *ad hoc* Committee [Klöckner v. Cameroon] and in literature . . .).¹⁶

The interpretation adopted by the *Klöckner–Amco* doctrine limits the role of international law in the second sentence of Article 42(1) to two situations: the application of international law must be justified either by the need to complement the law of the host State when it is presumed to contain *lacunae* on particular issues—

¹⁶ Amco v. Indonesia, *supra* note 14, ¶¶ 20-22 at 515 (emphasis added).

assuming legal orders are not complete¹⁷—or by the inadequacy of the law of the host State *vis-à-vis* the rules of international law.

It is submitted that the methodology offered by this doctrine, which has been espoused in ICSID case law¹⁸ and literature,¹⁹ does not grant international law its true role under Article 42(1).²⁰ At best, it takes international law into account

¹⁷ On the completeness of legal orders, see EMMANUEL GAILLARD, JOHN SAVAGE (EDS.), FOUCHARD GAILLARD GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION ¶¶ 1512 and 1557 (1999).

¹⁸ *Liberian Eastern Timber Corporation (LETCO) v. Republic of Liberia*, Award, Mar. 31, 1986, 26 I.L.M. 647, 658 (1987); *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, Award, Feb. 17, 2000, 15 ICSID REV. – FOREIGN INV. L.J. 169, 191 (2000).

¹⁹ See, e.g., Ibrahim Shihata and Antonio Parra, *Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*, 9 ICSID REV. – FOREIGN INV. L.J. 183, 191–95 (1994); CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 622 *et seq.*, in particular at 627–31 (2001); Berthold 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 États et ressortissants d'autres États*, in INVESTISSEMENTS ÉTRANGERS ET ARBITRAGE ENTRE ÉTATS ET PERSONNES PRIVÉES, LA CONVENTION B.I.R.D. DU 18 MARS 1965, 151 (1969); Andrea Giardina, *The International Center for Settlement of Investment Disputes between States and Nationals of other States (ICSID)*, in ESSAYS ON INTERNATIONAL COMMERCIAL ARBITRATION 214, 217 (P. Sarcevic ed., 1989); MOSHE HIRSCH, THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES 138, 140–41 (1993); John Westberg, *Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation; ICSID and Iran-United States Claims Tribunal Case Law Compared*, 8 ICSID REV. – FOREIGN INV. L.J. 3, 10 (1993); Abul F.M. MANIRUZZAMAN, *Conflict of Laws Issues in International Arbitration: Practice and Trends*, 9 ARB. INT'L 371, 399 *et seq.* (1993); Nagla Nassar, *Internationalization of State Contracts: ICSID, The Last Citadel*, 14(3) J. INT'L ARB. 185, 204–06 (1997).

²⁰ See Emmanuel Gaillard, *Centre international pour le règlement des différends relatifs aux investissements (C.I.R.D.I.) – Chronique des sentences arbitrales*, 118 JOURNAL DU DROIT INTERNATIONAL 165, 182–183 (1991): “Aussi

only in its public policy function and ignores its aptitude to serve as a body of substantive rules accessible to ICSID arbitral tribunals. Under this doctrine, the arbitral tribunal must always scrutinize the law of the host State before resorting to the rules of international law: it is only if it concludes that there are gaps in the law of the host State or if there is an inconsistency with the rules of international law that it is empowered to apply those rules. Furthermore, aside from giving preference to the application of the law of the host State, this theory does not take into account the fact that, by definition, the logic of inconsistency presumes that the rules of international law against which the conformity test is undertaken are “applicable”, *i.e.*, capable of being applied in the circumstances of the case. In other words, the assessment of whether or not the law of the host State is consistent with the rules of international law cannot be made in the abstract but on the basis of the *applicable* rules of international law.

In reality, the applicable rules of the law of the host State and the applicable rules of international may *differ* from one

l’habitude s’est-elle instaurée de considérer qu’il y avait lieu de partir de la loi de l’Etat d’accueil et de la compléter et, au besoin, de la modifier, par les principes de droit international si cette loi se trouvait entrer en contradiction avec ces principes . . . Cependant, *cette conception ne donne pas au droit international la place qui lui revient dans le système d’arbitrage CIRDI. Sans que l’on puisse pour autant parler de lacune du droit local ou de contrariété au droit international, le droit local peut différer des prescriptions du droit international*, qu’à la vérité les arbitres siégeant sous l’égide du CIRDI ont autant la charge de découvrir que d’appliquer . . . Dans un cas comme dans l’autre, le but est de donner aux arbitres une certaine liberté dans la découverte et la mise en œuvre des principes applicables, sans pour autant les transformer en amiables compositeurs, et sans qu’il leur soit nécessaire d’établir l’existence d’une lacune ou d’une contrariété du droit local avec le droit international. *Subordonner l’application des principes du droit international à la preuve d’une lacune ou d’une contrariété à l’ordre juridique international reviendrait à vider en grande partie l’article 42(1) de son sens et à remettre en cause l’équilibre qu’il a entendu instaurer*” (emphasis added).

another.²¹ The rules of domestic law may provide a solution different from those of international law, without violating them. If the word “and” in the second sentence of Article 42(1) of the Washington Convention is to be given a meaning, the choice of law rule contained in the second sentence of Article 42(1) should be understood as the “law of the Contracting State . . . and such rules of international law as may be applicable,” rather than as “the law of the Contracting State party to the dispute and, in case of *lacunae*, or should the law of the Contracting State be inconsistent with international law,” or even as “the law of the Contracting State party to the dispute and, subject to its collision with fundamental rules of international law.”²²

In other words, international law constitutes a legal order fully operating in both its public policy function and as a body of substantive rules (thus understood as covering the entirety of the sources set forth in Article 38 of the Statute of the International Court of Justice).²³

²¹ *Id.*

²² Regarding this interpretation, which also postulates that the application of international law in accordance with the second sentence of Article 42(1) of the Washington Convention is subject to the prior application of the law of the host State, see W. Michael Reisman, *The Regime for Lacunae in the ICSID Choice of Law Provision and the Question of Its Threshold*, 15 ICSID REV. – FOREIGN INV. L.J. 362 (2000).

²³ Those sources include “a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; b) international custom, as evidence of a general practice accepted as law; c) the general principles of law recognized by civilized nations; d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.” On the intention of the drafters of the Convention to understand “international law” within the meaning of Article 42(1) as defined in Article 38 of the Statute of the ICJ, see Memorandum from the General Counsel and Draft Report of the Executive Directors to accompany the Convention, Jan. 19, 1965, Document No. 128, *in* CONVENTION ON THE

This interpretation of the second sentence of Article 42(1) was adopted by the *ad hoc* Committee constituted in the *Wena v. Egypt* case. Having summarized the different meanings given to the choice of law provision in Article 42(1), the Committee unambiguously concluded that:

What is clear is that the sense and meaning of the negotiations leading to the second sentence of Article 42(1) allowed for *both legal orders to have a role*. The law of the host State can indeed be applied *in conjunction with international law* if this is justified. *So too international law can be applied by itself* if the appropriate rule is found in this other ambit.²⁴

The Committee's assessment that international law may be applied "by itself," as opposed to "solely"²⁵ or "only"²⁶ in cases of *lacunae* or inconsistencies, is a clear recognition that the choice of law process in Article 42(1) does not confine international law to a subsidiary role with respect to the law of the host State. It grants international law its true role under Article 42(1), that of a body of substantive rules freely accessible to ICSID arbitral tribunals.

In the circumstances of each case, the freedom of ICSID tribunals to resort directly to the rules of international law as the

SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES, DOCUMENTS CONCERNING THE ORIGIN AND THE FORMULATION OF THE CONVENTION, VOL. II, 962 (1968).

²⁴ *Wena v. Egypt*, Decision on application for annulment, *supra* note 3, ¶ 40 at 940–41 (emphasis added).

²⁵ *Klöckner v. Cameroon*, Decision annulling the award, *supra* note 13, ¶ 69 at 122.

²⁶ *Amco v. Indonesia*, Decision annulling the award, *supra* note 14, ¶ 20 at 515.

proper rules to resolve any of the issues brought to arbitration may be all the more justifiable in that, in treaty arbitration, what is at stake is the international responsibility of the host State under the relevant treaty and, therefore, under international law. However, the fact that the arbitration is based on a treaty does not alter the scope of the ICSID tribunals' power, under Article 42(1), to determine and apply the law they deem applicable. As a result, the extent of the review of the award rendered on such basis is not altered under the standards of Article 52 of the Washington Convention.

III. THE REVIEW OF THE APPLICABLE LAW IN TREATY ARBITRATION IS CARRIED OUT THROUGH THE MANIFEST EXCESS OF POWERS STANDARD OF ARTICLE 52 OF THE WASHINGTON CONVENTION

Although the Washington Convention does not provide for a specific ground for annulment of arbitral awards regarding the issue of the applicable law, ICSID case law has admitted that a tribunal's failure to apply the proper law—as opposed to a mere mistake in the application of the law—is subject to review under the manifest excess of powers standard of Article 52(1)(b) of the Washington Convention which provides that “[e]ither party may request annulment of the award . . . on one or more of the following grounds: . . . (b) that the Tribunal has manifestly exceeded its powers.”²⁷

It has been submitted that it is irrelevant, for the purposes of Article 52(1)(b), that the failure to apply the proper law relates to the first or the second sentence of Article 42(1) of the

²⁷ See, on this issue in general, SCHREUER, *supra* note 19, ¶¶ 163–217 at 943–66.

Convention.²⁸ This view accurately reflects the fact that, when the parties have provided for the applicable law—which, in treaty arbitration, is constituted by any choice of law provision contained in the treaty—their choice forms part of their arbitration agreement and a tribunal’s failure to give effect to that agreement may amount to a manifest excess of powers.²⁹ Similarly, when there is an agreement between the disputing parties referring to ICSID arbitration, the choice of law rule contained in the second sentence of Article 42(1) also constitutes a contractual arrangement between the parties.³⁰ In these cases, the review of the award is based on the assessment of whether the tribunal has, or has not, departed from the choice of the applicable law by the disputing parties.

In treaty arbitration, and in the absence of a choice of the applicable law by the parties, the issue is: should the review of the award take into account the tribunal’s determination of the proper law in accordance with the second sentence of Article 42(1). In other words, whether the review may comprise the extent to which the tribunal has not applied, or has not applied, each of the components of the choice of law rule in Article 42(1) of the Convention, namely the law of the host State and the rules of international law.

The answer to this question depends on the interpretation to be given to the freedom of ICSID tribunals to determine the proper law in the second sentence of Article 42(1) of the Convention. Under the *Klöckner–Amco* doctrine, an award could conceivably

²⁸ See SCHREUER, *supra* note 19, ¶ 172 at 946, referring to Aron Broches, *Observations on the Finality of ICSID Awards*, 6 ICSID REV. – FOREIGN INV. L.J. 321, 345–6 (1991).

²⁹ *Cf.*, e.g., *Maritime International Nominees Establishment v. Republic of Guinea*, Decision partially annulling the award, Dec. 22, 1989, 4 ICSID REP. 79, 87 (1997).

³⁰ SCHREUER, *supra* note 19, ¶ 172 at 946.

be annulled for having applied the rules of international law beyond a “corrective” or “complementary” function. Much will then depend on the *ad hoc* committee’s view of whether the law of the host State was sufficiently scrutinized or whether or not the recourse to international law was warranted by a gap in the law of the host State. Under the *Wena* doctrine, however, the tribunal can freely access the rules of international law without any requirement of prior scrutiny into the law of the host State given that the two bodies of law equally constitute the proper law that may be applied by a tribunal under the second sentence of Article 42(1). As a result, the review of a tribunal’s manifest excess of powers will not be concerned with the more or less broad recourse to the rules of international law. Depending on the circumstances of each case, the arbitral tribunal has a margin and power of interpretation with respect to the applicability of each of the rules of domestic law and of the rules of international law. The *ad hoc* Committee in *Wena* emphasized the ICSID tribunals’ degree of discretion in the determination of the proper law in the following terms:

[Referring to the *Klöckner* and *Amco* decisions, as well as the view according to which international law is applicable in instances of a collision with norms of *jus cogens*] Some of these views have in common the fact that they are aimed at restricting the role of international law and highlighting that of the law of the host State. Conversely, the view that calls for a broad application of international law aims at restricting the role of the law of the host State. There seems not to be a single answer as to which of these approaches is the correct one. The circumstances of each case may justify one or another solution. However, this Committee’s task is not to elaborate precise conclusions on this matter, but only to *decide whether the Tribunal manifestly exceeded its powers with respect to Article 42(1) of the ICSID Convention*. Further, the use of the word ‘may’ in the second sentence of this provision indicates that the Convention does not draw a sharp line for the distinction of

the respective scope of international and of domestic law and, correspondingly, that this has the effect to *confer on to the Tribunal a certain margin and power for interpretation*.³¹

In line with this rationale, the Arbitral Tribunal constituted in *Aucon v. Venezuela* recognized its discretion in determining whether or not the rules of international law were applicable in the circumstances of the case:

The role of international law in ICSID practice is not entirely clear. It is certainly well settled that international law may fill lacunae when national law lacks rules on certain issues (so called complementary function). It is also established that it may correct the result of the application of national law when the latter violates international law (corrective function) Does the role of international law extend beyond these functions? The recent decision of the ICSID Ad Hoc Committee in *Wena Hotels Ltd. v. Arab Republic of Egypt* accepts the possibility of a broad approach to the role of international law, and that the arbitral tribunal has a “a certain margin and power of interpretation” (ICSID Case Nr. ARB/98/4, 41 I.L.M. 933 (2002), Nr. 39 p. 941). Whatever the extent of the role that international law plays under Article 42(1) (second sentence), *this Tribunal believes that there is no reason in this case, considering especially that it is a contract not a treaty arbitration, to go beyond the corrective and supplemental functions of international law*.³²

³¹ *Wena v. Egypt*, Decision on application for annulment, *supra* note 3, ¶¶ 38–39 at 941 (emphasis added).

³² *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, Award, Sept. 23, 2003, available on the ICSID website, ¶ 102 (emphasis added).

The Tribunal in *Aucon* chose not to go beyond the corrective and supplemental functions of international law—which were considered by the *Klöckner–Amco* doctrine as the exclusive functions of international law in the second sentence of Article 42(1) of the Convention—but to limit itself to Venezuelan law and international law when its rules prevailed over conflicting national rules. This decision, which is justified by the circumstances of the case, seems to indicate that the Tribunal in *Aucon* recognized its power of interpretation to decide whether or not to apply the rules of international law. It is of particular significance that the Tribunal considered the circumstances of the case as entailing the fact that the arbitration was initiated on the basis of a contract and not an investment treaty. The Tribunal subsequently decided not to award compound interest on the basis that it was warranted, in the case at hand, by neither domestic law (which does not provide for it) nor international law (which allows it but does not require it).

The same issue was resolved, in the *Wena* case, by the Tribunal's recourse, under the circumstances of the case, to the rules of international law allowing for compound interest and the *ad hoc* Committee's conclusion that the Tribunal had not manifestly exceeded its powers by awarding compound interest (which, according to Egypt, the host State having applied for annulment, was not an option under Egyptian law):

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. 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.*³³

Both the *ad hoc* Committee decision in *Wena* and the award in *Aucoven* show the extent to which ICSID case law has evolved since the *Klöckner* and *Amco* cases. Whereas the first *ad hoc* Committees envisaged international law exclusively in its corrective or supplemental function, in line with their narrow view of the choice of law rule in the second sentence of Article 42(1), the decisions in *Wena* and *Aucoven* have espoused the principle according to which each tribunal has the freedom to resort to the rules of international law, including for the purpose of their corrective or supplemental function, if the circumstances of the case so require.

Under the second sentence of Article 42(1), ICSID tribunals have a duty neither to apply nor to refuse to apply international law, but simply the discretionary power to have recourse, when appropriate, to its rules. Because this determination falls within the ICSID tribunals' power and varies from one case to the other, an *ad hoc* committee constituted under Article 52 of the Washington Convention should be extremely mindful of the thin line between what constitutes an annulment and what constitutes an appeal, and limit its control to the "manifest" nature of any excess of powers.

³³ *Wena v. Egypt*, Decision on application for annulment, *supra* note 3, ¶ 53 at 943 (emphasis added).