Abstract
The law applicable to arbitral proceedings in general, and to investor-State arbitral disputes in particular, has always been a conundrum. This is for a simple reason: arbitral proceedings are detached from any national legal system. Given this, the question raised is how to let arbitrators determine the applicable law for the dispute. The solution provided by arbitral clauses enacted within arbitral rules of procedures, or investment treaties, are slightly different. Namely, the freedom conferred upon the arbitral tribunal to determine the applicable law, absent any party’s choice, has raised much debate among both academics and the jurisprudential praxis. This paper aims to reopen the debate on the lex applicable in investor-State dispute settlements. After providing some historical background on arbitral proceedings, along with the interpretation and application given to ICSID Convention art. 42,(1), the analysis will then show that the recent arbitral praxis has had to tackle a third set of laws. Reference will be made to European union law, questioning whether and how arbitral tribunals should apply European law in disputes arising out of so-called intra-EU BITs or the Energy Charter Treaty. Some conclusions on the relationship between international and European law will then be attempted.

Keywords: International investment law; investment arbitration; law applicable; European and international law relationship; Bilateral investment treaties; intra-EU BITs.

1. INTRODUCTION

The investor-state dispute settlement is an arbitral dispute resolution mechanism which is an alternative to national jurisdiction1. Its origin dates back to when, in 1959, the first bilateral investment treaty (BIT) was signed between Germany and Pakistan. Both parties agreed to get rid of national court competence, favoring as alternative forums either the International Court of Justice or an ad hoc arbitral tribunal. The latter would have had the competence to hear and solve all disputes arising out of the parties’ investment relationship. Over the years, the investor-state arbitral dispute resolution mechanism has become the most frequent option agreed on by parties and has been enacted within investment treaties, both bilateral and multilateral.

This choice has implied two consequences: on one side, the investor’s home state has given up its power to protect its investor through either diplomatic protection or through domestic proceedings. On the other side, the host state has agreed to confer competence to rule over its measures to a third forum: the arbitral one. However, state sovereignty has always been preserved thanks to the customary international rule prescribing the exhaustion of local remedies2. According to this, foreign investors seeking redress for any infringement allegedly caused by the host State must first pursue the claims in the host state’s jurisdiction. Only then, in case of a lack of redress, is the investor allowed to start arbitral proceedings.

The rationale behind the investor-state arbitral proceeding choice is easy to understand: it reflects a disbelief of the national judicial system. This disbelief has a historical background: the first round of investment agreements was signed between developed and developing countries and the judicial systems within the latter were

1 Billiet J. (2016); Rubino-Sammartano M. (2001)
not considered to abide by international principles of procedural law such as the right of defense, the right to be heard and the right to have a third and impartial judge.

From this the decision was derived to confer competence to hear disputes (those precisely defined in the arbitral clause) upon an arbitral tribunal. Firstly, arbitral tribunals operate outside of any legal system; suffice to say that they are legitimized by the arbitral clause enacted in the investment treaty itself. Secondly, they guarantee a procedure which abides by the international principles of procedural law. In this regard, two options soon became available; namely, the arbitral clause can refer to either ad hoc arbitration (applying the arbitral rules of procedures chosen in the arbitral clause, such as the UNCITRAL Model Law); or the arbitral clause can refer to institutional mechanisms of dispute resolution (such as those provided by the International Center for the Settlement of Investment Disputes, 1959, ICSID).

Frequently, an arbitral clause gives investors the choice to decide between both options, the ad hoc and the institutional.

Along with rules of procedure, the arbitral clause confers upon the parties the freedom to determine which law will regulate the dispute. This freedom has a very strong implication when made available within investment proceedings. As mentioned above, arbitral tribunals are separate from legal systems therefore neither national nor international provisions, to which the national system has adapted to, are applicable, ex se, to the proceedings. The choice of law is then fundamental because it can determine the outcome of the case.

Given the above, the issue of the applicable law in investor-state arbitration is not a new one. During the last decades both academics and arbitral case law have debated on it. Namely, the debate has, for a long time, focused on the relationship between the proper national and/or international law provisions to apply to the case3.

Recent praxis seems to have reinvigorated the debate and, in fact, a third legal system option is now applicable and is in competition with the other two, namely the European union.

The new role played by the European union within the investment field has a historical background. In 2009, the Lisbon Treaty conferred, upon the EU, competence for foreign direct investments (FDI). As a consequence, the European union has been playing a leading role in substituting member state investment policies with a European one (the extra-EU BITs have not caused much concern)4. 

*Viceversa,* the maintenance into force of the intra-EU BITs have raised much debate5.

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The debate is now over, with the member states having reached an agreement on a plurilateral treaty for the termination of all the approximately 190 intra-EU BITs\(^6\). However, while the legal value of the intra-EU BITs is still uncertain, numerous arbitral proceedings have been raised relating to their alleged infringement or to that of the Energy Charter Treaty (ECT), signed by the EU, the member states, and third countries. The facts at stake have always been the same, and the key issue concerns the relationship between the sources of law allegedly applicable to the pending proceeding: European and international. Each arbitral tribunal has thus scrutinized whether, according to the rules of the law applicable to the proceeding, it should consider the European or the international law as the applicable law. This, in turn, has meant, and still means, questioning whether or not European union law applies when the parties to the intra-EU BIT have not made an expression of choice of law. In light of the above premises, this paper aims to reopen the debate on the

lex applicable in investor-state arbitral proceedings, focusing on new doubts raised by recent arbitral praxis. The next paragraph provides a general overview of the tools used by the arbitral tribunal to determine the applicable law. In this regard, attention will be paid to the applicable law provision enacted in both \textit{ad hoc} and institutional arbitral procedural rules (para. 2). The analysis will then focus on ICSID art. 42(1), first alinea, examining the role of the arbitral tribunals in cases where parties have expressed their \textit{optio legis} (para. 3). Then, this paper will analyze art. 42(1) second alinea, scrutinizing how the old arbitral praxis was interpreted and applied. At the beginning, the latter was used in a subsidiary way (para. 4). Then subsequent paragraphs will retrace the evolution of interpretation after the decision in the Wena Hotel annulment proceeding. Since then a new praxis has evolved, aimed at legitimizing the autonomy of international law (para. 5). The analysis will then focus on the relationship with the \textit{corpora iuridica}, which may be applicable in a dispute arising out of an intra-EU BIT or out of the ECT. Special attention will be given to the potential struggle between the contents of these two bodies of law (European and international) where these are equally applicable. In this regard, two main questions arise: firstly, whether or not a real conflict exists between international and European provisions and, secondly, which law prevails for the host-member state involved. This paper will also question whether the European union primauté applies to international law (para. 6) and the last paragraph will scrutinize how the EU is now pursuing its external investment policy with third countries. Accordingly, this paper will examine the legitimacy of the arbitral clause, included in new European investment treaties. Reference will be made to the recent decision of the European Court of Justice (ECJ) in the so-called Achmea case (C-284/18) along with the Opinion 1/17 (para. 7). Some conclusions will then be attempted (para. 8).

2. **The role of arbitral tribunal in determining the law applicable to an investor-state arbitral dispute**

When a dispute arises out of an investment agreement and the claimant starts a proceeding in front of an arbitral tribunal, either ad hoc or institutional, arbitrators have the power to, firstly, recognize and confirm their competence and secondly, to deal with the issue of the applicable law. The determination of the applicable law is of fundamental importance to an arbitral dispute since the law applied may affect the outcome of the dispute. In fact, the law regulates how the obligations agreed on by the parties shall be interpreted and performed.

This determination depends on numerous factors. Firstly, the arbitral tribunal has to understand the claims relevant to the proceedings. If they are contractual claims, and the treaty enacts an umbrella clause, arbitrators will scrutinize the contract signed by the investor and the host state. Frequently, contract claims do not raise much concern, because the parties agree to subsume their contractual relationship to the national law of the host state. Besides, in the case of treaty claims, arbitrators look at the arbitral clause enacted within the treaty. On close scrutiny, the clause itself can be framed in two ways. It can include an express choice of law made by the parties, or it can leave the choice up to the arbitral tribunal. In this latter scenario, the international rules of arbitral procedure instruct arbitrators on how to make their choice from amongst the available sources of law. A few examples of the most frequently used arbitral clauses from both ad hoc and institutional arbitral procedures, might be of help in this regard.

With regards to the former, the UNCITRAL arbitral rules of procedure provide, in art. 35.1, that the arbitrator “shall apply the rules of law designated by the parties [...] Failing such designation by the parties, the arbitral tribunal shall apply the law which it determines to be appropriate”. As such, both parties and arbitrators have the freedom to decide which law to apply. The former are free to decide from amongst all the “rules of law” available. This means that parties can pick from both national law provisions and rules of law which are separate from any national legal system (such as, for instance, the lex mercatoria). In the absence of either party’s choice, arbitrators can choose from amongst the sources of law they deem more appropriate to the controversy.

Regarding institutional arbitral mechanisms, the first to mention is the ICSID Convention art. 42(1), according to which “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

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law as may be applicable”

Art. 42(1) distinguishes between two scenarios: on one side, the parties explicitly decide the rules of law that the arbitrator will be bound to apply. On the other hand, art. 42(1) acknowledges that, absent any choice, the arbitral tribunal will apply the law of the state party to the dispute.

Analogous freedom to choose from amongst rules of law is also embraced by other arbitral rules of procedures enacted within institutional arbitral mechanisms. Reference is made to art. 21 of the International Chamber of Commerce arbitration rules according to which “the parties shall be free to agree upon the rules of law to be applied. In the absence of any such agreement, the arbitral tribunal apply the rules of law which it determines to be appropriate”.

Also, art. 27 of the Stockholm Chamber of Commerce arbitral rules of procedures states that “the Arbitral Tribunal shall decide the merits of the dispute on the basis of the law(s) or rules of law agreed upon by the parties. In the absence of such agreement, the Arbitral Tribunal shall apply the law or rules of law that it considers most appropriate”.

In both cases, absent any explicit choice of law, arbitrators are free to determine the law they deem appropriate in order to solve the dispute.

According to the above provisions, in case a dispute arises out of an intra-EU BIT, European union law can also be invoked, either as the law chosen directly by the parties or applied as part of the national or the international law that arbitrators deem appropriate. This second option is possible because of the “multi-sided” nature of the European union: it forms a part of both member states’ national laws and international law. Indeed, the European union is grounded in the so-called fundamental treaties, which are international treaties. More precisely, the European union can be described as "an ordre juridique d’origine internationale".

Besides, there are also some international treaties which include an arbitral clause. Accordingly, they provide a procedural framework within which any dispute between the parties has to be decided. The North American Free Trade Agreement (NAFTA) provides in art. 1131 that “A tribunal established under this Section shall decide the issues in dispute in accordance with this agreement and applicable rules of international law”; the second paragraph also makes clear that any interpretation on the agreement provided by the Commission on Free Trade “shall bind the Tribunal”. This provision certainly reduces arbitral freedom of interpretation as arbitrators are bound to apply NAFTA substantive provisions, as interpreted by the Commission (along with any applicable international rules). However, a uniform interpretation increases the chance of having the same factual situation decided in

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10 See the International Centre for the Settlement of Investment Disputes, ICSID Convention Arbitration Rules, 1st January 1968, art. 42(1).


14 North America Free Trade Agreement, signed 17 December 1992, Ch. 11.
the same way which, in turn, reduces the need to determine the correct interpretation of the treaty or law to be applied.

With regards to other experiments of regionalization, it is interesting that the new European investment agreements do include an arbitral clause. Regarding the applicable law, the Comprehensive Economic Trade Agreement (CETA) signed between Europe, the member states and Canada and now under provisional application provides, in art. 8.31, that “1. the Tribunal shall apply this Agreement as interpreted in accordance with the Vienna Convention on the Law of Treaties, and other rules and principles of international law applicable between the Parties”.

Lastly, it is worth mentioning the arbitral clause framed in art. 26 of the ECT, according to which “a tribunal established […] shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law”.

As with the NAFTA and the CETA, the ECT also includes substantive provisions applicable to disputes, thus reducing the parties’ freedom to refer to other sources of law. Only in case of need may international law and principles become of any relevance. Interestingly to note, arbitral provisions such as those enacted within the above-mentioned multilateral investment treaties, introduce a certain dialogue between particular laws (enacted within the treaty itself) and general ones (the international law provisions potentially relevant to the case). The combination of these two sources of law renders the host state’s national law useless. Conferring such a residual role (or even none) upon the host state’s national law also implies an indirect harmonization of decisions taken. In fact, all analogous claims will be scrutinized with the same substantive provisions, while national law will be mentioned only as a fact. The basic requirement for this type of intransitive, or informal, harmonization in law, is “effectuating as understanding of different legal concepts”.

3. ICSID ART. 42.(1) OR, THE RELATIONSHIP BETWEEN INTERNATIONAL AND NATIONAL LAW. THE OPTIO LEGIS

From the analysis so far developed it seems that, despite some slight differences, all arbitral rules of procedure confer, upon the arbitral tribunal, the duty to follow parties’ choice or, in the absence of this, the power to freely make their own.

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This and the following paragraph focus on the functioning of ICSID art. 42.(1) first and second alinea. This provision has indeed raised much debate on the relationship between international and national law which may be applicable to the dispute. This issue has interested both academics and arbitral case law, but neither has yet found a definitive answer. The debate should now be reopened because the role potentially played by European union law should be scrutinized in both scenarios: in the case of an express choice of law by the parties or absent this.

Art. 42.(1) first alinea deals with the case where parties have expressed their choice of law. Parties’ freedom is broad, given that they can pick from the rules of law as they prefer. Plus, the provision does not require that the parties’ agreement has to be expressed and in written form. Interestingly to note, during the drafting of the ICISD, the Convention Committee highlighted that a tribunal could be bound to apply the rules of law which derive by an implicit agreement which could be deduced from the facts and circumstances of the relationship between the parties.20

Following a literal interpretation of the provision, the application of European union law should not be in doubt. In fact, academics and case law unanimously conclude that the expression “rules of laws” (which is found in the English version 21 and not “laws”), confers upon the parties the right to refer to non-state rules also. This means that it is sufficient that the parties choose rules which are enacted within either a judicial legal system (the European union) or a social group (lex mercatoria).

However, the role of the European union may change depending on how the arbitral tribunal interprets the parties’ choice of law. It suffices here to recall the Duke Energy v. Equador award where the arbitral tribunal reasoned on how broadly it had to interpret the optio legis made by the parties. Indeed, the clause included in the investment agreement stated that the arbitral tribunal would determine the investment dispute “under the laws of Ecuador and the applicable principles of international law [...] the standard of review being based on the terms of the BIT”22. The question was whether or not the parties, when deciding that the principles of international law were applicable to the dispute, meant to include the BIT provisions too.23 This doubt was legitimate because the investment treaty’s praxis counts numerous BITs in which the arbitral clause clearly states that the BIT provisions are applicable along with “the principles of international law”24 or “the applicable rules of international law”25.

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21 The Spanish version repeats verbatim the English one, referring to “aquellas normas de derecho internacional” while the French formulation raises confusion, referring to: “les principes de droit international en la matière”.


24 See the BITs of: Argentina, Belgium, Luxembourg, Chile, China, Costa Rica, Ecuador, Spain, (the BIT with Mexico is excluded).
The BIT in the Duke Energy case did not include such a stipulation, therefore the arbitral tribunal considered whether or not it should apply the BIT provisions to determine whether they were breached by the State measure allegedly impairing investors’ rights. If used as a standard of review, the BIT provisions might have led the arbitral tribunal to question whether the measure abided by the substantive provisions of the BIT interpreted and applied in line with international law. *Viceversa,* BIT provisions would have been applied “*only as the substantive framework for the resolution of the dispute*” 26.

Given this scenario, the arbitral tribunal decided that a double scrutiny was required. Firstly, the state’s measure was to be read together with the host state’s national law (and whether this was legitimate or not); then, in case of a positive answer, the arbitral tribunal would have to decide whether the measure was in line with, for instance, the standard of treatment as provided in the BIT. Therefore, the provisions included in the BIT were deemed to be part of the international rules referred to in the arbitral clause. The arbitral tribunal’s finding seems reasonable given that it treats the BIT as a truly international source of law which might also include some international principles of law27.

Given this, in a case where a dispute arises out of an intra-EU BIT, the decision to apply the BIT’s substantive provisions as a standard of review might preclude European union law application because the BITs provisions will be interpreted and applied according to international law. This also precludes the application of the European standard of protection, which could be applicable if the arbitrators decided to apply international law.

4. *follow: ICSID ART. 42(1), SECOND ALINEA*

ICSID Convention art. 42(1) second *alinea* works as a choice of law clause given that it confers upon the arbitral tribunal the power to determine the law to apply. The provision was originally drafted as art. 35.1 UNCITRAL arbitral rules of procedures and conferred upon the arbitrators the right to “*decide the dispute [...] in accordance with such rules of law, whether national or international, as it shall determine to be applicable*”28. Such an open formula was framed in the first ICSID Convention draft where the version of the arbitral clause mentioned that art. 38 of the Statute of the International Court of Justice was a tool to be used to find the applicable law. However, while negotiating the final version of the ICSID Convention, a major political change occurred and the version that it is now in force was accepted.

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25 See the BITs signed between Canada and: Armenia, Barbados, Croatia, Ecuador, Egypt, Latvia, Lebanon, Panama, Philippines, South Africa, Romania, Trinidad and Tobago, Ukraine and Venezuela.


Contrary to the “original” version, the one now in force represents a “compromise” 29. It reduces the arbitral tribunal’s power to determine the applicable law, whilst preserving its freedom to apply international law. In fact, art. 42.(1) second alinea sets boundaries while identifying the set of laws within which arbitrators are required to make their choice.

Given this, the interpretation and application of art. 42.(1) second alinea raises much concern because the relationship between the host state’s law and the international law is unclear. Namely, it is still much-debated whether the two corpora iuridica are applicable together or as alternatives or, whether one plays a primary role over the other.

The issue is easy to understand because it derives from the wording of the Convention itself: according to art. 42.(1) ICSID, in the absence of any express choice of law, the arbitrators apply the contracting parties’ national law and international law. However, it is not clear what role the Convention’s committee had in mind for international law. Since the early stages of the Convention’s application, it was unclear whether arbitrators could decide to apply international law alone, instead of the host state’s national law; or, whether they were bound to limit the application of international law. Given this uncertainty, earlier arbitral case law praxis applied international law only in a limited way.

Namely, the decision of the ad hoc Committee in the Klöckner v. Republic of Cameroon annulment proceeding gave birth to the theory that international law could play only a supplementary or a corrective role with respect to national law.

In detail, in the Klöckner annulment decision, the ad hoc Committee was required to understand whether or not the arbitral tribunal had manifestly exceeded its power when choosing the law to apply. Indeed, the arbitral tribunal had applied “other national codes” along with “the universal requirements of frankness and loyalty” 30. While questioning the legitimacy of the application of these principles of international law, the ad hoc Committee also highlighted that art. 42.(1) second alinea, legitimized the application of international principles of law conferring them: “a twofold 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 and after having applied the relevant rules of the State's law” 31. According to the ad hoc Committee, the arbitral tribunal had correctly applied the above sources of law, given that they were part of the “general principles of law recognized by civilized nations” 32.

29 See Broches A. (1967), at 16.
30 See Klöckner v. United Republic of Cameroon, ICSID case ARB/81/2, decision of the ad hoc Committee in the annulment procedure, 21st October 1983, para 66.
31 Id. para 61.
32 Id. para 69.
Since then, arbitrators have conferred a residual role upon international law. In more detail, international law is used in a supplementary way when arbitrators decide to apply national law as the proper law but they find that the latter has a lacuna. However, this approach seems to be grounded on a false premise for two reasons. Firstly, international law cannot be used to fill all, alleged, gaps of the national legal system involved - if the latter does not provide any remedies for a certain act or measure this does not necessarily represent a lacuna. On the contrary, it might reflect the state’s choice not to regulate a certain matter\textsuperscript{33}. Secondly, the lacuna only truly exists if there is a socio-legal lag\textsuperscript{34} when, for instance, the state is ready, or is about to, regulate a certain matter but it has not enacted any regulations yet. Given this case, national legal systems do frequently have general principles and customary provisions to cover legal positions not yet regulated by a specific domestic provision. Therefore, even in the case of an alleged lacuna, arbitrators should first scrutinize whether the relevant matter is otherwise provided for within the domestic legal framework itself. Then, only in the case of a negative answer, should the arbitrators look at international law. This line of reasoning is grounded in legal logic, however, it confers a wide discretion upon the arbitrator. In practice, international law will be applied in a supplementary way depending on how thoroughly arbitrators have scrutinized the national legal system. This means that international law is applicable only if arbitrators have not found any domestic principles to fill the gap, notwithstanding how closely arbitrators have scrutinized the domestic legal system. In addition, a general consideration seems unavoidable: if international law is used to fill a national legal system gap, arbitrators might find the host state in breach of an international law provision. The result would be that national and international law would then be interchangeable. But this is not the case. As a matter of principle, national and international provisions have two distinct amits of application: national law regulates interindividual relationships, while international law regulates states as sovereign entities governing the international community. In cases where arbitrators apply the national law only, they will not question the international responsibility of the State and this will be the case even where state international responsibility exists. As such, the alleged supplementary role of international law, as left to arbitral discretion, should be avoided.

Besides, international law is allegedly playing a corrective role when the application of national law turns out to be in conflict with a principle of international law. This interpretation relies on an early interpretation of ICSID Convention art. 42.(1) (then art. 45) provided by the Convention Committee working on the ICSID travaux: “the laws of the host country would be of primary importance and that international law itself would in the first place refer to them” \textsuperscript{35}. According to the Committee, arbitrators should first apply domestic law; secondly, domestic law had to be tested.

\textsuperscript{33} Weil, P. (2000).

\textsuperscript{34} Reisman W. M. (2000), p. 371.

\textsuperscript{35} See the Summary Proceedings of the Legal Committee Meeting, December the 7th, in 2 ICSID Documents, p. 804.
against international law. If the result was a conflict with international law, then the former could not be applied.

This conclusion is not convincing. In fact, the ICSID Convention should be interpreted according to the relevant international law provisions; namely, art. 31 of VCLT states that a “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the contract”. Only in the case of an obscure result, might one recur to the supplementary means of interpretation referred in art, 32 VCLT. Given the clear wording of art. 42.(1), the need to return to the history of the ICSID Convention to interpret it, is doubtful. Instead, one should question when the domestic law provision applicable to a dispute will result in a conflict with a principle of international law, so making international law applicable in a corrective way.

If one follows a broad interpretation of conflict, art. 42.(1) ICSID would be deprived of any meaning because such an interpretation would make international law applicable only at the arbitrator’s discretion. Therefore, a clear distinction between what is a conflict and what is a difference between an international and a domestic provision is much needed. The ICSID committee clearly had in mind the set of provisions that could not be infringed by domestic law application. While negotiating an early draft of the Convention, reference was made to art. 53 of the VCLT. According to this, a conflict exists only when the application of a national law results in a contrast with an international provision of jus cogens. However, this rule does not provide a practical example, it has merely a prescriptive nature (that a treaty is void when it conflicts with a provision of international law). The International Law Commission (ILC), in the commentary on the Vienna Convention draft articles, refused to make a list of jus cogens rules. According to the ILC: “the full content of this rule [the jus cogens ones] is to be worked out in State practice and in jurisprudence of international tribunal [...]”. No specification is then needed ex ante because “first, the mention of some cases of treaties for conflict with a rule of jus cogens might, even with the most careful drafting, lead to misunderstanding as to the position concerning other cases not mentioned in the article. Secondly, if the commission were to attempt to draw up [...] a list of the rules of international law which are to be regarded as having the character of jus cogens, it might find engaged in a prolonged study.” Absent any further indication, one has to adapt the ILC reasoning to art. 42.(1) second alinea. As a consequence, the conclusion can be reached that the arbitral tribunals receive their power from an international treaty (the investment ones). As such, they are organs of international law and they cannot apply any domestic law provision which results in a contrast with a fundamental value protected within the International Community.


With regards to the early arbitral praxis, for a long time after the Klöckner annulment decision, arbitral tribunals applied international law either in a supplementary or corrective way, without even distinguishing between contracts and treaty claims, which require different treatment. This reference to previous decisions proves also that the doctrine of precedent plays a role within the arbitral praxis. Even if ICISID arbitral tribunals are not bound by other decisions they often do, in practice, rely on precedent. From the above, it can be derived that the use of international law in a supplementary or corrective way has a purely jurisprudential nature and, as already stated, has no legal basis; neither in the wording of art. 42.(1) nor in the travaux of the Convention. This leads to the conclusion that, for a long time, ICSID art. 42.(1) has been improperly interpreted, following the interpretation given by the Convention Committee and later confirmed in early case law.

5. ICSID CASE LAW: FROM KLÖCKNER TO WENA HOTELS V. EGYPT

The jurisprudential approach towards the interpretation of art. 42.(1) second alinea was first eroded by the ICSID tribunal in Siemens AG v. Argentine Republic, when the arbitral tribunal refused to consider that international law played, in the alternative, a supplementary or a corrective role. According to the tribunal, given that the case arose out of the alleged treaty infringement committed by Argentina “the Tribunal’s inquiry is governed by the ICSID Convention, by the BIT and by applicable international law. Argentina’s domestic law constitutes evidence of the measures taken by Argentina and of Argentina’s conduct in relation to its commitments under the BIT.”

Afterwards, this line of reasoning was also embraced by the ad hoc Committee in Wena Hotels LTD v. the Arab Republic of Egypt annulment proceeding. In this case, the ad hoc Committee stated that: “[art.42.1] allowed for both [domestic and international] 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.”

39 See supra note 7. See Amco Asia Corporation and others v. Republic of Indonesia, ICSID Case No. ARB/81/1, Decision on the Application for Annulment, May 16, 1986.


42 See supra note n. 7.


44 Id. 78.

45 Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID case n. 98/4, award of 8 December 2000.
The rationale behind the decision is easy to understand. One of the grounds for requesting the annulment concerned the manifest excess of power used by the arbitral tribunal. In actual fact, the failure to apply the proper law may constitute a manifest excess of power. In this case, according to the applicant, the arbitral tribunal had failed to apply international law as the primary law (namely the agreement for the promotion and protection of investments signed between the United Kingdom (the investor home state) and Egypt). The *ad hoc* Committee rejected the applicant’s request as, according to the *ad hoc* Committee, the arbitral tribunal’s finding on the wording of ICSID art. 42.(1) was to be followed. The use of *may*, along with the conjunction *and*, leads to two concurrent options for application: either national and international rules are applied in tandem or they are applied autonomously. Therefore, international rules can too be considered as a set of autonomous rules which may supersede national law. There can also be cases where the arbitral tribunal finds both a national and an international law provision equally applicable, then it is up to the arbitral tribunal itself to decide to apply the latter as the proper law, without the need for any further justification. According to this, in the Wena Hotel annulment proceeding, art. 42.(1) ICSID was interpreted and applied as never before.

In fact, for the first time, an ICSID *ad hoc* Committee had acknowledged that its scrutiny could actually trigger the host state’s international responsibility. This notwithstanding the fact that a measure abides by the host state’s domestic provisions. In other words, an “expropriatory” measure can be allowed by national law whilst at the same time infringing a provision on expropriation in the relevant investment agreement. It is needless to recall that investment treaties have an international nature, therefore one could also argue that international law might be applied as the proper law, notwithstanding art. 42.(1) ICSID. Indeed, art. 3 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts, states that “The characterization of an act of a state as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law” 46. Therefore, to qualify as an act committed by a state towards a foreign investor, the international law should apply *proprio vigore*, notwithstanding how the national law concerned interprets it.

Some scholars have strongly opposed the conclusion reached by the Wena *ad hoc* Committee on the assumption that it did not consider the amendment made by the Convention Committee between the early and the final drafts of the convention. In fact, the final version of art. 42.(1) ICSID drastically reduced arbitral tribunal freedom to determine which law to apply. The early draft provided that the “arbitral tribunal shall decide the dispute submitted to it in accordance with such rules of law, whether national or international, as it shall determine to be applicable” as already mentioned, the final version changed slightly, stating that “the Tribunal shall apply the law of the contracting State party to the dispute [...] and such rules of international law as may be applicable”. Clearly, the first draft conferred much more

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discretion upon arbitral tribunals; however, it is clear too that the final version still leaves it up to the tribunal to determine whether, and to what extent, international law shall apply.

In this regard, the finding of the ad hoc Committee is of much interest because it has made the relationship clear between the national and international law that is potentially applicable to investor-state disputes. Namely, that the arbitral tribunal is allowed to determine the applicable law on a case by case basis, having also regard to the nature of claims. In the case of treaty claims, and in the absence of any optio legis, the tribunal can therefore apply international law as the proper law.

In acknowledging the primary role of international law, the ad hoc Committee also implicitly acknowledged that investment treaties do create an autonomous legal system which does not exist in a vacuum but is linked to the international and national legal systems.

Accordingly, all arbitral tribunals have to clearly distinguish between the host state and the investor position as derived out of the investment agreement. With regards to the former, the arbitral tribunal has to scrutinize the host state obligations, bearing in mind that they derive out of the investment treaty and have an international nature. With regards to the latter, arbitrators have to consider that the investment treaty’s legal system confers an active position upon the private investor towards the host state. Foreign investors do indeed have the power to seek protection against host state wrongdoing through the arbitral proceeding. As a consequence, it might be argued that ICSID art. 42(1) has a residual role to give evidence of the investor’s juridical position towards the host state. In this scenario, the foreign investor seems to be in a similar position (or even equal) to that of any European economic operator. Indeed, the EU legal system provides that its provisions are directly applicable to both the national and the administrative member state courts. Therefore, before these courts, individuals are allowed to seek protection for any member state’s alleged infringement of an EU provision. Investment treaties confer an equal prerogative upon investors who are allowed to bring a claim against the host State directly in front of the arbitral tribunal, even if the relevant source of law was agreed upon between the host state and the investor home state47.

6. THE (POSSIBLE) COORDINATION OF INTERNATIONAL AND EUROPEAN LAW: THE ARBITRAL PRAXIS ON INTRA-EU BITs

The Lisbon Treaty entered into force in 2009 amending, amongst others, art. 207 of TFEU. The new version of the article also conferred, upon the members of the European Common Commercial Policy (CCP), competence for foreign direct investments (FDI)48. According to art. 3.(1) TFEU therefore, the EU has exclusive competence for CCP and, since 2009, the EU has started to shape its own policy on


FDI, working on two-level fields: on one side, the EU has tackled the issue of both the extra and the intra-EU BITs already in-force; on the other, the EU has opened negotiations for concluding investment agreements with third countries in a mixed or in a bilateral way.

The main issue that has been tackled has concerned the legitimacy of the arbitral clause. Accordingly, maintaining the arbitral clause, within the intra-EU BITs, has been questioned. In parallel, doubts have been raised regarding the opportunity to include an arbitral clause within the new EU trade and investment agreements.

The reason behind the EU’s hostile approach towards the investor-state arbitral proceedings is clear: EU law interpretation and application is an ECJ prerogative (see artt. 252 ss. TFEU). Therefore, any potential arbitral tribunal’s scrutiny of EU law should be avoided or, at least, made compatible with the ECJ prerogative.

The next paragraph will deal with the intra-EU BITs, leaving the issue concerning the new European trade and investment agreements to the proceeding one.

With regards to the intra-EU BITs, the member states agreed, in October 2019, on a plurilateral treaty for the termination of bilateral investment treaties. This treaty is the result of almost a decade of debate on the legitimacy of maintaining the intra-EU BITs already in force. The treaty’s aim is to coordinate the termination of the intra-EU BITs without unduly impairing foreign investors and also provides some specific provisions with regards to pending, or already initiated, arbitral proceedings.

In fact, since 2009 the intra-EU BITs have been the object of numerous arbitral proceedings. In addition, EU investors have raised arbitral proceedings against a member state for alleged infringement of the ECT’s investment chapter.

In both scenarios, the facts have been almost the same: the investor has claimed that its investment has been impaired by a measure enacted by the host state. While the latter, being both the host and a member state, has replied that it has acted in accordance with an EU obligation. If one assumes the European union perspective, the relationship between international and European law should mirror the one existing between the EU and its member states: it has to be read in the light of the theory of limits and counter-limits. As such, international law enters the European union system provided its provisions abide by the European public order. In other words, international law must abide by the “very foundations of the Community legal order.”

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49 Neframi E. (2002); Kuiper P. (1995); Stein E. (1990), at 162.

50 See supra note 6.


54 See the Opinion delivered pursuant to the second subparagraph of Article 228 (1) of the Treaty - draft agreement between the Community, on the one hand, and the countries of the European Free Trade Association, on the other, relating to the creation of the European Economic Area, ECJ Opinion delivered in case C-1/91 on 14 December 1991, ECLI:EU:C:1991:490.
that all member states are bound to comply with European law as well as with their international obligations, it is essential to understand what rank the provisions assume within the domestic legal system. In fact, European law primauté and, as the case may be, its direct application, operate only towards member state national law.

However, the content of the two provisions at stake (one enacted in the investment treaty and the other in the European legal system) might be in alleged conflict and have equal rank within domestic sources of law.

In all the proceedings so far mentioned, the arbitral tribunals have concluded that the member state measure infringed the BIT or the ECT provision, regardless of whether or not the measure enacted by the state complied with an EU obligation itself. In other words, the legitimacy of the state measure with European union law has not even been taken into consideration.

What is of interest, in the present analysis, is how arbitral tribunals have reasoned on the lex applicable issue and therefore on the role that the EU should have played. Firstly, it should be highlighted that arbitrators have never directly applied EU law. Instead, they have focused on the possible application of the European union provision as part of either the national or the international legal system. In fact, at least from a theoretical perspective European law provisions could be applied in both scenarios. However, the praxis has shown that applying provisions as part of the international or the national legal system produces different legal effects.

With regards to the former, when European law applies as part of international law its application has the same boundary as that referred above regarding the possible application of national law: namely, the European union provisions must abide by the principles of international law. This boundary can be easily understood because the European legal system is subject to all the rules that apply to the international legal system, of which the European union is a part. In this regard, the arbitral tribunal in Electrabel v. Hungary held that "all [European] legal rules are part of a regional system of international law and therefore have an international legal character."


56 See Bermann G. (2016) at 434; see also, Klabbers J. (2011); Flaminio Costa v. Enel, ECJ case C-6/64, judgment of 15th July 1964, ECLI:EU:C:1964:66.


Besides, in the Achmea (formerly Eureko) case, the arbitral tribunal legitimized the reference to European law assuming that "in principle the EU legal doctrines, including those of supremacy, precedence, direct effect, direct applicability is part of the EU law that might fall to be applied by the Tribunal in this case under art. 8.6 of the BIT" 60. The arbitral tribunal also stated that its jurisdiction was based on the BIT, therefore the consequences of applying European law must be assessed "within the framework of the rules of international law and not in disregard of those rules" 61. As a consequence, European union law provisions could potentially be applied when a disputed arbitral clause enacted within the investment treaty provides that "the law in force of the contracting party concerned, the provisions of this agreement, and other relevant agreements between the contracting parties and the principle of international law" 62.

With regards to the second option, when European union law has been applied as part of domestic law, the arbitral tribunals have applied it as a fact. As such, EU law has been used to frame the circumstances of the case, assisting judges engaged in hermeneutic interpretive activities. Therefore, European law has become an instrument for identifying the substantive rules that are suitable for the case. In AES v. Hungary, the tribunal highlighted that the agreement between the parties (the ECT) provided a clause according to which the law applicable to an arbitral dispute would be the ECT provisions along with the principles of international law. Given this, the arbitral tribunal acknowledged that EU law should be considered as a fact: "Community law, including Community competition law, is considered the equivalent of internal or municipal law for the purpose of the proceeding. Community law is thus merely a fact to be considered by the tribunal when determining the law applicable" 63.

The award was later subject to an annulment proceeding. Amongst the grounds for the annulment, the applicant claimed that the arbitrators had manifestly exceeded their powers. According to the applicant, the arbitral tribunal omitted to question the legality of the contested measure under both Hungarian and EU law. However, the ad hoc Committee claimed that "the question of legality under Hungarian and EU law was a significant issue in the original proceedings [...]" 64. However, even if European law had been applied, the outcome of the dispute would not have changed because, according to the ad hoc Committee: "had Hungary been motivated to reintroduce price regulation with a view to addressing the EC's state aid concerns, there is no doubt that this would have constituted a rational public policy measure" 65.

60 Achmea B.V. v. The Slovak Republic, PCA Case No. 2008-13 (formerly Eureko B.V. v. The Slovak Republic, Award on Jurisdiction, Arbitrability and Suspension, 26th October 2010, par. 289.
61 Id. para. 229.
62 Id. para 231.
63 AES Summit Generation Limited and Aes-Tisza Erömü Kft v. the Republic of Hungary, ICSID Case No. ARB/07/22, award, 23rd September 2010, para. 7.3.4.
64 AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary, ICSID Case No. ARB/07/22, Decision of the ad hoc Committee on the Application for annulment, 29th December 2012, para. 162.
In Electrabel v. Hungary the arbitral tribunal came to an analogous conclusion when reasoning on the dual potential application of EU law. According to the arbitrators, European union law can be applied as part of the international legal system when the arbitral clause states that a dispute shall be decided with “the law in force of the contracting party concerned, the provisions of this agreement, and other relevant agreements between the contracting parties and the principle of international law”. Viceversa, “EU law must in any event be considered as part of the Respondent’s national legal order, i.e. to be treated as a “fact” before this international tribunal” As a consequence, when arbitrators apply European law as a fact, they implicitly limit their scrutiny on the European judicial order. Such an approach is not a new one and seems to reveal a monistic approach which favors the international legal system’s sources of law.

In all the above-mentioned cases, arbitrators scrutinized the measure adopted by the respondent state without questioning the measure’s legitimacy under EU law. To reach the conclusion that the international obligation enacted in the investment treaty applies, notwithstanding the European Union ones, arbitral tribunals have applied international rules on treaties enacted in the VCLT (art. 30.3 and art. 59) along with the principles of customary law enacted by the ILC report on the Fragmentation of International Law. This legal reasoning seems to be the correct one, also because in no case have the parties been able to prove that the obligations enacted in the investment treaty and in the European treaties were in real conflict (meaning that the two provisions could not have been applied contemporarily). Therefore, the host-member states were not bound by two equally applicable provisions. The arbitrators have thus avoided getting involved in the debate concerning whether or not the international legal system will supersede the European one or viceversa. This debate is still open and it may arise again in the pending arbitral disputes on intra-EU BIT or the ECT. If a real conflict arises between the content of the two provisions one could expect two solutions, depending on the approach that the arbitrators follow. In the first solution, the arbitral tribunal, when it is possible, will solve the conflict by finding a balance between the obligations enacted under the relevant international and European provisions. In other words, excluding an isolationist approach (according to which a source of law, rectius the legal system within which it has been enacted, must be interpreted as being disconnected from others) arbitrators should follow a systematic evolutionary interpretation. They have therefore to interpret the

65 Id. para. 172.

66 Electrabel v. Ungheria, quoted, par. 4.127 ss..

67 See German Interest in Polish Upper Silesia v. Poland, Permanent Court of International Justice, judgement of 25 august 1925, PCIJ (ser. A) no. 6, p.19; see also, India-Patent Protection for Pharmaceutical and Agricultural Chemical Products, WTO AB in case WT/DS50/AB/R decision of 16 April 1999, paras. 65-66.

68 See supra note 57.
obligations enacted within the provisions in mutual support of one another. This approach finds legitimacy in articles 31.1 and 31.3. (c) of the Vienna Convention of the Law of Treaties, 1969.

On the other side, the arbitral tribunal can let the European provision prevail in a case where the defendant host-member state’s enacted measure abides by the European public order. In this situation, arbitrators will always reject the exceptions regarding European law primauté as this prerogative only applies to internal relations between the EU and the member states.

7. … follow: THE ARBITRAL CLAUSE IN THE NEW EU INVESTMENT AGREEMENTS

Since the European union was given competence over FDI, it has started to frame its own investment policy with third countries. Accordingly, the EU has opened investment treaty negotiations with all potential partners. To date, some negotiations have been suspended due to political reasons (such as TTIP); some are still pending (see EU-Singapore and EU-Vietnam) and some have been concluded already (CETA).

Each negotiation has its peculiarities; however, all have raised much debate – still open – also with regard to the opportunity to include an arbitral clause. Indeed, the EU’s concern has always been to preclude non-EU forum from interpreting and applying European union law. Both these prerogatives are conferred, as mentioned above, upon the ECJ.

The so called “Micula saga” represents well the efforts made by the EU Commission to avoid intra-EU arbitral proceedings, even at the cost of precluding, due to illegitimacy, a member state from enforcing an arbitral award which might potentially have led to a conflict with an EU provision. Particularly, in this case, according to the Commission, the enforcement of the award would have been equal to state aid.

However, it seems the risk feared by the Commission is more political than legal. Firstly, the arbitral clause framed in the investment agreement does not allow the


73 See Ioan Micula, Viorel Micula, S.C. European Food S.A., S.C., Starmill S.r.l. and Multipack S.r.l. v. Romania, ICSID case No. ARB/05/20, Award, 11 December 2013.

arbitral tribunal to scrutinize and rule on the legitimacy, or not, of an EU law provision. Secondly, any arbitral mistake in applying or failing to apply, EU law can be amended if the recognition and the execution of the award is requested. In fact, such proceedings are raised in front of member state domestic courts which, according to art. 267 TFEU\textsuperscript{75}, do have the power to request the ECJ’s opinion on the final and definitive interpretation to give to a European law.

Given the above-mentioned political scenario, the legitimacy of the arbitral clause has been the object of ECJ scrutiny. Namely, in the Achmea decision the Court denied the maintenance into force of the arbitral clause in the intra-EU BITs (not the ECT). According to the ECJ: “[…] in order to ensure that the specific characteristics and the autonomy of the EU legal order are preserved, the Treaties have established a judicial system intended to ensure consistency and uniformity in the interpretation of EU law […] by concluding the BIT, the Member States parties to it established a mechanism for settling disputes which could prevent those disputes from being resolved in a manner that ensures the full effectiveness of EU law”\textsuperscript{76}. This notwithstanding that, to date, as shown in the above paragraph, an arbitral tribunal has not questioned the legitimacy of an EU provision. This decision has raised a debate about whether or not the new EU investment agreement should have dealt with the issue on arbitral proceedings and applicable law.

As a result, in the new European investment agreements, the negotiators have framed arbitral clauses balancing two necessities: the European union’s hostility towards intra-EU investor-state arbitral proceedings and third-countries’ refusal to get rid of arbitral proceedings.

In this paragraph, we will limit the analysis to the arbitral clause enacted within the CETA; namely, art. 8.31 confer upon arbitrators the right to determine the disputes according to the agreement provisions, along with the rules or the principles of the international law which may result applicable. Also, paragraph 2 provides that: “the Tribunal shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of this Agreement, under the domestic law of the disputing Party. For greater certainty, in determining the consistency of a measure with this Agreement, the Tribunal may consider, as appropriate, the domestic law of the disputing Party as a matter of fact”\textsuperscript{77}.

From the clause’s wording, two conclusions might be derived. The clause works as an express optio legis, given that parties have determined which rules of law must be applied if a dispute arises. Any reference to EU law is absent; therefore, the arbitrators might use it only as a fact. This limitation in turn precludes any incorrect interpretation and application of European union law. Also, the arbitral clause’s second paragraph seems to go a step further: it states that the arbitrators cannot determine the legality of the relevant measure by applying the host-member

\textsuperscript{75} Paschalidis (2016); Szpunar M. (2017), p. 85 ss..

\textsuperscript{76} Slovak Republic v. Achmea B.V., ECJ case C-284/16, 6\textsuperscript{th} march 2018, ECLI:EU:C:2018:158, paras. 32-33 and 56.

state’s domestic law. Once again, this means that domestic law can be used only as a fact, interpreted in line with how it is applied by domestic legislators and courts. As such, the clause seems to mirror the European approach towards investor State arbitral proceedings. Once it was realized that Europe could not force third parties to negotiate an investment agreement without an arbitral clause, European union negotiators have found a way to frame them in a European-acceptable way. It is worthwhile mentioning the recent ECJ Opinion n. 1/17 where the Court stated that the arbitral clause enacted within the CETA is compatible with EU Law. European union negotiators have endorsed an equal approach in the UNCITRAL Committee constituted to establish procedural rules for an international investment court. In pursuing this path, the EU is somehow legitimizing the primacy played by international law in its external investment relations.

8. Conclusion

This analysis has tried to reopen the debate on an old issue. Indeed, the question concerning the lex applicable to investor-state arbitral proceedings has always been the object of close scrutiny. This is because arbitral tribunals are detached from any legal system and so, from any national provisions. As such, determining the applicable law represents a delicate task. The main difficulties arise when the parties have not made an express choice of law. In these circumstances, arbitral tribunals are required to determine the applicable law by following what is stated in the arbitral clause. In this regard, ICSID art. 42.(1) has, for a long time, caught the attention of both academics and the case law praxis. The debate has mostly concerned the role played by international law itself along with the relationship between international law and national law. As seen, originally international law played a supplementary or a corrective role with respect to national law. Only after the ad hoc Committee’s decision in the Wena Hotels annulment proceeding, has international law started to be applied autonomously as the proper law.

In fact, this should have been the approach since early case law. Treaty claims arise out of an international agreement - a BIT or a multilateral investment treaty. As such, treaty provisions should be interpreted and applied within their own legal system. This, at the cost of favoring a monistic approach according to which international law supersedes national law, not vice versa.

This analysis has attempted to show that the debate on the lex applicable within investor-state arbitral proceedings has been complicated by the “entrance” of a third system of law. In this respect, reference was made to the numerous arbitral proceedings arising out of either an intra-EU BIT or the ECT. These proceedings have raised questions about the role European law should play with respect to

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international and national law. Absent any express choice, European law could be applicable as part of international law or, as part of national law. In other words, European union law provisions could have easily been included within the functioning of the ICSID art. 42(1).

However, recent praxis has shown that, in the arbitral proceedings arising out of intra-EU BITs or out of the ECT, the arbitrators have not questioned the legitimacy of host state measures with respect to the EU provision allegedly binding it. In fact, legitimacy was not an issue because arbitrators applied the international law provisions enacted within the treaty. Notwithstanding this, the European institutions have recently reached the goal of getting rid of intra-EU arbitral proceedings: the plurilateral treaty on intra-EU BIT termination, above all, will preclude the arisal of any future arbitral disputes concerning alleged conflict between an EU and an international provision. Within the internal market, the European union’s monistic approach has then prevailed, in which the European union obligations are above the international investment one. Contrarily, with regards to external relations, the EU has had to accept the inclusion of arbitral clauses in new European union trade and investment agreements. The clauses so far enacted have been framed in a European-acceptable way, thus avoiding any incertitude with regards to the role – absent – of EU law.

From this, a general conclusion can be attempted. International law and the international legal system are becoming primary law in each and every investor-state arbitral proceeding even when the relationship concerns the EU and third countries.
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