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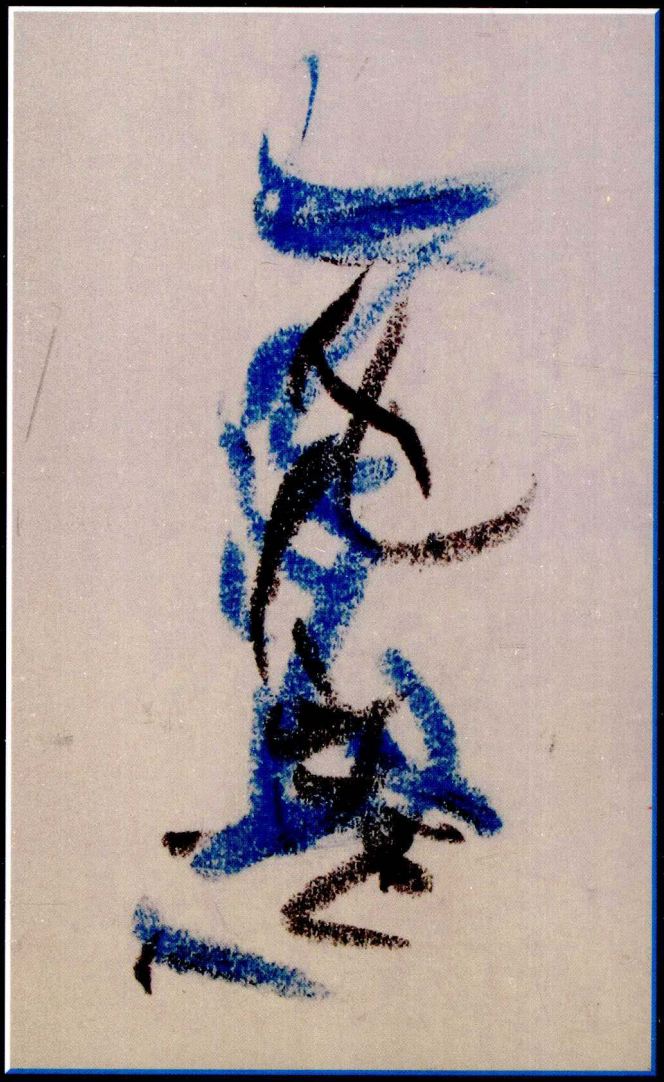

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KLUWER LAW INTERNATIONAL

Substantive Law in Investment Treaty Arbitration

The Unsettled Relationship between International Law and Municipal Law

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Preface

It is now widely accepted that international arbitration pursuant to bilateral investment treaties (BITs) has become a separate, specialist field of dispute resolution. Practitioners flaunt their treaty arbitration credentials; academic law departments offer courses in international investment law; blogs are devoted to the array of issues comprehended in investment cases; and government ministries give the responsibility for defending these claims to lawyers with public international law expertise. Moreover, unlike commercial arbitration, where it makes little sense to evaluate arbitrators as 'claimant oriented' or 'respondent oriented', investors and States spend a significant amount of time trying to determine from an arbitrator's writings and rulings whether he is more attuned to the interests of investor-claimants or State-respondents.

It may seem perverse to characterize a dispute resolution field as 'thriving', given that the proliferation of disputes may not in and of itself be regarded as a healthy economic development. But even in this respect international investment arbitration has a point of difference – or at least positive spin – to offer: investment treaty tribunals arguably reduce State – State tensions, by providing a well-defined and increasingly used alternative to diplomatic confrontation. The availability of this alternative may encourage the infusion of investment capital. Furthermore States need not feel beleaguered by the increasing number of arbitrations: (i) they can and sometimes do this defeat investors' claims; and (ii) in any event, the existence of investment treaty arbitration is a good incentive for States to adhere to the rule of law and to practice good government.

Still, it must be acknowledged that practitioners, academics and students all have an interest in the growth of their field, and this interest can foster a partial perspective. According to this perspective, the more BITs (and the more disputes) the better, and the reluctance of some States to enter into BITs or to provide in their

BITs broad and diffuse protections for investors may be blithely criticized as a lack of confidence in public international law.

Specialists also have an interest in keeping their field regarded as different and special. To borrow from Freud, the need to distinguish oneself from others encourages the narcissism of small differences. It also can create an insularity and attention to process and procedure at the expense of an understanding of substantive law. In the field of international investment law, where so-called 'transnational policies' frequently creep into decision making, and where the content of the substantive law can be difficult to ascertain, there is a need for analytical rigour devoted to substantive law. That is why I have written this book, and that is what I hope to achieve.

There is no shortage of commentators in this field. Each award or decision occasions a spate of articles. Monographs on particular topics on increasingly common, and – manifesting the growth of the field – a number of works of synthesis in which authors restate 'principles' have appeared. These works are particularly important: without a movement toward some common understanding of protections such as fair and equitable treatment, and indirect expropriation, and without some convergence between tribunal awards on recurring issues, the growth of the field will be slowed.

While this book addresses several of the same issues as the synthetic works on investment treaty disputes, my focus is on the relationship between international law and municipal law. A sound analytical framework for this relationship is crucial to the further development of international investment arbitration. Treaties are international instruments entered into by States, prescribing international standards of protection. However, the beneficiaries of treaty protection are entities or individuals – the investors – who have made investments as designated by a treaty. These beneficiaries are subject to municipal law, which also governs the underlying investment that the treaty addresses. A key issue for investment treaty tribunals is how to define an international law right in the absence of corresponding institutions in international law to which the tribunals can resort.

This book analyses six areas in which application of international law inevitably entails consideration of municipal law: (i) attribution under the law of State Responsibility, (ii) the concept of investment, (iii) investor's nationality, (iv) the definition of property, (v) the definition of shareholders' rights, (vi) the issue of contract versus treaty claims, and (vii) umbrella clauses. The centrepiece of the book's attempt to establish an analytically sound framework for the international law/municipal law relationship will be controversial, as it draws from the approach adopted by the International Court of Justice in *Barcelona Traction* – an often-cited, much criticized, but, for the most part, inadequately examined diplomatic protection case. This book demonstrates that certain principles adopted in the context of diplomatic protection should be applied to investment treaty disputes. *Barcelona Traction* also provides a vantage point for understanding why a number of investment treaty tribunals have misapplied or even ignored municipal law, thereby diminishing their attempts to develop international investment law.

The range of arguments regarding the role of municipal law has tended to oscillate between extremes: on the one hand, it is contended that international law contains a complete definition of rights and displaces municipal law; on the other hand, it is said that international law is an empty shell that must be filled by a *renvoi* to municipal law. Neither of these extremes can be sustained. The former cannot account for the reality that international law does not contain a substantive definition of all the rights that are the subject matter of investment treaties. For example, international law does not define property rights, and a definition that disregards the content of municipal law would be an ad hoc definition adopted for the purpose of resolving a single dispute. If that approach is taken, there will be no certainty as to the content of the subject matters of investment treaties, and investment tribunals will have a discretion that is far too broad in deciding a dispute. However, the 'empty shell' approach is also unacceptably flawed. A *renvoi* to municipal law that does not take into account international law would run afoul of the principle that international law governs the characterization of a State act as an internationally wrongful act.

A more nuanced and rigorous application of the *renvoi* to municipal law is needed for international investment law to thrive and international investment arbitration to retain the confidence of all participants, investor and State. The following chapters seek to achieve this nuance and rigour.

Acknowledgements

This book is a revised version of my doctoral dissertation, which was supervised by Professor James Crawford, Director of the Lauterpacht Centre, Whewell Professor of International Law, University of Cambridge. Professor Crawford's eminence in the field of public international law, and, in particular, international investment law and arbitration, made my doctoral studies at Cambridge a truly enlightening experience. While I recognize that he did not always agree with the conclusions that I reached about the relationship of international and municipal law, Professor Crawford made me earn my conclusions by subjecting each line of the dissertation to his exacting eye. I am very grateful to him.

I am also grateful to my examiners at Cambridge, Zachary Douglas (Jesus College, Cambridge) and Federico Ortino (King's College, University of London), who enabled me to turn a dissertation into a book by conducting a rigorous VIVA and by making many suggestions for improvements. They, like Professor Crawford and all other readers of my dissertation, are of course absolved of any responsibility for any errors of fact or law or infelicitous prose that may inhabit this book.

I would like to note the intellectual and professional guidance that I received from Loukas Mistelis, the Clive M. Schmitthoff Professor of Transnational Commercial Law and Arbitration at Queen Mary, University of London, and from Norah Gallagher, Director of the Investment Treaty Forum, British Institute of International and Comparative Law. Professor Mark Kantor (Georgetown University) kindly shared his knowledge of the US Model BITs with me, and Professor Andrea Bjorklund (University of California, Davis) greatly assisted my understanding of several topics in investment treaty arbitration.

It was a great pleasure to have been a graduate student at Hughes Hall College, Cambridge, and I shall remain a devoted alumna of Hughes Hall. I would like to note, in particular, the financial assistance that I received through the William Charnley Law Scholarship, administered by the college. I would also like to

thank the staff and scholars associated with the Lauterpacht Institute and the Squire Law Library, University of Cambridge, for their intellectual camaraderie and many kindnesses. In particular, I would like to thank David Wills, Squire Law Librarian; Mrs Lesley Dingle, Foreign and International Law Librarian; and Ms Kay Naylor, Librarian's Secretary and Senior Library Assistant.

Two professors in Italy have had an enormous influence on my career in the law. I worked for a number of years at Studio Legale Chiomenti in Rome with Professor Andrea Giardina and Professor Maria Beatrice Deli. They have been, and remain, wonderful mentors; their guidance has touched virtually everything I have done in my legal practice and in my academic work.

Professor Julian D.M. Lew QC, 20 Essex Street Chambers and Queen Mary, University of London, encouraged me to turn my dissertation into a book, and brought me to Kluwer Law, where I have had the benefit of working with Eleanor Taylor and Vincent Verschoor. But Dr Lew also did much else: he permitted me to work with him when he was a partner at Herbert Smith LLP in London, which entailed taking a chance on an Italian lawyer who had not then practiced outside Rome. He was and continues to be unfailingly generous with his time and his immense knowledge of international arbitration. I could not have hoped for a better mentor in England. He truly changed the direction of my life and legal career.

My children, Jacob and Micol, were born during my doctoral studies. They provided daily reminders of my need to complete my dissertation expeditiously. That need, however, would have gone unfulfilled without the incredible support of my parents.

Above all, my gratitude goes to my husband Larry, who supported me in many ways and without whom I would never have been able to complete the dissertation and then the book. Thanks to his unwavering enthusiasm and encouragement, I was able to complete my studies.

List of Abbreviations

BIT	Bilateral Investment Treaty
ECHR	European Court of Human Rights
ECJ	European Court of Justice
ECT	Energy Charter Treaty
IACHR	Inter-American Court of Human Rights
ICJ	International Court of Justice
ILC	International Law Commission
MAI	Multilateral Agreement on Investment
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Co-operation and Development
PCIJ	Permanent Court of International Justice

Introduction

The Unsettled Relationship between International Law and Municipal Law

[N]o subordination of international responsibility, as such, to the provisions of municipal law is involved; the point is rather that the very existence of the international obligation depends on a state of affairs created in municipal law, though this is so not by virtue of municipal law but, on the contrary, by virtue of the international rule itself, which to that end refers to the law of the State. . . . [T]here is on the one hand a set of rights conferred by the municipal order on the company and, on the other hand, within the same legal order, another, quite distinct set of rights conferred on the members. Each set of rights is entitled to its own, distinct international protection.

– Judge Gaetano Morelli[1]

1. *BARCELONA TRACTION* AND *RENVOI* TO MUNICIPAL LAW

Judge Morelli's statement in *Barcelona Traction* explains the relationship between international and municipal law in the context of diplomatic protection. In *Barcelona Traction* the International Court of Justice (ICJ) had to determine whether Belgium could seek reparation from Spain for damages suffered by its nationals, shareholders of a Canadian company. The key question was whether Spain owed an international obligation to Belgium, such that Belgium could bring a diplomatic protection claim. The ICJ addressed this question by considering

1. *Barcelona Traction, Light and Power Company, Limited*, Judgment, *ICJ Reports* (5 Feb. 1970): 3; Separate Opinion of Judge Morelli, 234–235, paras 4 and 5.

whether the Belgian shareholders had suffered an injury to a *right*, as opposed to an *interest*.

The ICJ concluded that Belgium had failed to establish *ius standi*. It held that the violation of the company's rights and the resulting damage to the shareholders did not constitute a violation of shareholders' rights. The analysis of the company's rights versus the shareholders' rights was undertaken in accordance with the 'relevant institutions of municipal law'.[2] In particular, the ICJ stated that it had 'not only to take cognizance of municipal law but also to refer to it. It is to rules generally accepted by municipal legal systems which recognize the limited company whose capital is represented by shares, and not to the municipal law of a particular State, that international law refers'.[3]

The case displayed a significant array of approaches to the relationship between international and municipal law in the application of public international law. At one end of the spectrum, Judge Morelli opined that if international law does not regulate certain concepts, a *renvoi* to municipal law must be conducted. At the other end of the spectrum, Judge Gros opined that only international law should apply; municipal law should be ignored, and economic realities had to be considered. In between – though much closer to Morelli – stood the ICJ majority, with its *renvoi* to municipal legal systems rather than municipal law. The 'municipal legal system' was not intended to be the municipal law of the respondent State, but instead referred to universal principles drawn from municipal laws. The application of principles differs from the application of international law alone, because the source of these principles is a comparative analysis of municipal laws.

The ICJ majority's approach, then, was that rights had to be defined in accordance with municipal legal systems if there were 'no corresponding institutions of international law to which the Court could resort'.[4] Since in *Barcelona Traction* the shareholders were not vested with any rights under municipal law, and economic damage did not equate to injury to a right on the international plane, Belgium had no right of action.

The ICJ and Morelli approaches could have led to different results because the ICJ looked to rules generally accepted by the 'municipal legal systems', whereas Morelli focused exclusively on the respondent State's municipal law. Judge Morelli's view was that under international law each State was required to respect foreigners' rights, and in *Barcelona Traction* the extent of shareholders' rights had to be determined in accordance with the Spanish legal system.[5] However, both approaches were fundamentally similar in requiring a *renvoi* from international law to another set of rules for the determination of shareholders' rights.[6]

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2. *Barcelona Traction*, 37, para. 50.
3. *Ibid.*
4. *Ibid.*
5. *Ibid.*, Separate Opinion of Judge Morelli, 235, para. 5.
6. The term *renvoi* is used in this book to mean a *renvoi* to the substantive law of a State and not to its conflict of laws rules. See, on *renvoi*, Dicey, Morris & Collins, *The Conflict of Laws* (London, 2006), Ch. 4, 73.

Judge Gros' Separate Opinion and Judge ad hoc Riphagen's Dissenting Opinion rejected *renvoi*. Judge Gros did so because he believed that it led to the supremacy of municipal law over international law, by referring the assessment of the existence of a right to municipal law.[7] He considered rules of municipal law to be mere facts in evidence. According to Judge Gros, the ICJ should have regarded the legal relationship in question under municipal law as a fact to be tested 'against the rules of international law'.[8] The *renvoi* method ignored the point that an irregular expropriation was a breach of international law.[9] Alien shareholders, he remarked, should not run the risk of seeing their investment disappear as a result of unlawful acts, even if those acts are formally targeted at a domestic corporation.

Judge Gros' position was that the legal analysis under international law had to take into account the economic facts and the effects upon investments of unlawful State acts, since the rule of international law prohibited expropriation without compensation.[10] He focused on economic realities to determine whether reparation may be sought.[11] Judge Riphagen's Dissent went even further: he regarded international law and municipal law as completely separate spheres. The treatment of aliens is, he stated, regulated by rules of customary international law.[12]

Judge Gros' economic realities approach echoes the position taken almost a half-century earlier in *Certain German Interests in Polish Upper Silesia.*[13] The Permanent Court of International Justice (PCIJ) had ruled in 1926 that 'municipal laws are merely facts which express the will and constitute the activities of States'.[14] The PCIJ would not interpret a municipal law 'as such',[15] but could decide whether the application of a municipal law was in conformity with a State's international obligation. In *Barcelona Traction* the ICJ also did not interpret municipal law as 'such'. Rather, it applied international law, and in doing so emphasized the need, in certain circumstances, to refer to municipal law. Municipal law was relevant to the extent that international law needed to refer to it to determine the existence of rights relevant on the international plane. Municipal laws therefore were not merely facts that expressed the will of States. *Renvoi* to municipal law, or municipal legal systems, was by the time of *Barcelona Traction* an aspect of application of international law.

The matter of *renvoi* was previously discussed in the Advisory Opinion on the *Exchange of Greek and Turkish Population.*[16] In that case the PCIJ had to interpret

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7. *Barcelona Traction*, Separate Opinion of Judge Gros, 272–273, paras 9–11.
8. *Ibid.*, para. 10.
9. *Ibid.*, 273–274, para. 12.
10. *Ibid.*, 279, para. 19.
11. *Ibid.*
12. *Barcelona Traction*, Dissenting Opinion of Judge Riphagen, 335–338, paras 3 and 4 in particular.
13. *Certain German Interests in Polish Upper Silesia* (Merits), Judgment, 25 May 1926, PCIJ Series A, No. 7, 1.
14. *Ibid.*, 19.
15. *Ibid.*
16. *Exchange of Greek and Turkish Population*, Advisory Opinion no. 10, 21 Feb. 1925, PCIJ, Series B, No. 10, 6.

the word 'established' in Article 2 of the Convention of Lausanne of 30 January 1923, concerning the exchange of Greek and Turkish Population,[17] and whether to apply Greek and Turkish law to determine if the population were 'established'. Since the Convention of Lausanne did not define the term, the PCIJ had to assess whether there was an implied reference to Greek and Turkish law. In resolving this issue, the PCIJ distinguished between (a) the national status of a person, which 'can only be based on the law of that State, and whereas, therefore, any convention dealing with this status must implicitly refer to the national legislation';[18] and (b) a mere situation of fact, defined by the Convention without any *renvoi* to national legislation.

Having observed that 'established' was not a term of art, the PCIJ construed the term according to its natural meaning and not by reference to national legislation. The PCIJ deemed it significant that the intention of Greece and Turkey was to accord the same treatment to their populations once the division was carried out. The term 'established' should not allow different meanings based on the application of different municipal laws, because this would have led to the division of the population being carried out in different manners in Turkey and in Greece, and this was contrary with the spirit of the Convention.[19] But the Advisory Opinion accepted that when a treaty refers to a legal concept with no express direction on how to interpret it, there may be a *renvoi* to a municipal law, unless the interpretation of the concept under municipal law conflicts with the intention of the State parties to the relevant treaty, and the treaty is 'self-contained'.[20]

The ICJ in *Barcelona Traction* was engaged in a different task than the PCIJ in *Exchange of Greek and Turkish Population.* In the latter, the PCJI dealt with the interpretation of a term that was not considered a term of art, in an international 'self-contained' treaty, whereas the ICJ was assessing a term of art and, in particular, whether customary international law could grant diplomatic protection to shareholders' rights. From this difference stems the diverse approach to *renvoi*, which was applied in *Barcelona Traction* and not in *Exchange of Greek and Turkish Population.*

The issue of *renvoi* should not be confused, as Judge Gros' Separate Opinion confused it, with the relationship of municipal law to the sources of international law. Judge Anzilotti's Individual Opinion in *Consistency of Certain Danzig Legislative Decrees with the Constitution of the Free City*[21] dealt with this point. He explained that the PCIJ was created to 'administer international law',[22] and that the interpretation of municipal law cannot be carried out apart from any question of international law. Anzilotti clarified that despite being separate, international law

17. *Ibid.*, 7.
18. *Ibid.*, 19.
19. *Ibid.*, 20.
20. *Ibid.*, 19–20.
21. *Consistency of Certain Danzig Legislative Decrees with the Constitution of the Free City*, Advisory Opinion, 4 Dec. 1935, PCIJ, Series A/B, No. 65, 41.
22. *Ibid.*, 61–62.

may refer to municipal law.[23] In earlier writings, he had identified two different categories of *renvoi*: (i) substantive *renvoi*, under which the rule of municipal law becomes a rule of international law, and (ii) formal *renvoi*, where the reference to a rule of municipal law serves only to determine the applicability of the international law rule without the rule's migrating from the international law plane to the municipal law plane or vice versa.[24] Anzilotti considered formal *renvoi*, by which there is no transformation of rules, to be the category most frequently applied by international courts and tribunals. He gave as examples of this category the protection of nationals and determination of nationality by *renvoi* to municipal law, and the determination and protection of license rights under the relevant municipal law. Formal *renvoi*, as we have seen, became the ICJ's approach in *Barcelona Traction*, in the context of diplomatic protection.

2. INVESTMENT TREATY PROTECTION AND THE CONTINUING RELEVANCE OF MUNICIPAL LAW

The ICJ's and Judge Morelli's guidance seem, at first glance, less appropriate when the arena is investment treaty protection rather than diplomatic protection. Investment treaties are international instruments entered into by States, laying down international standards of protection. But the beneficiaries of this treaty protection are entities or individuals – the investors – in relation to their individual investments. These beneficiaries are subject to municipal law, which also governs the underlying investment that the treaty addresses. The interplay between international and municipal law has led one scholar to refer to the investment treaty regime as having a 'hybrid or sui generis character'.[25]

The movement of individuals or entities from 'object' to 'subject' of public international law has fostered the possibility of conflicts between international law and municipal law, because international law is no longer only applicable between States.[26] Judge Morelli's position in *Barcelona Traction* overcame the

23. *Ibid.*, 63, '[T]he Court, in performing its function as an organ of international law, may have to consider municipal laws from two entirely distinct standpoints. In the first place, it may have to examine municipal laws from the standpoint of their consistency with international law. (...) Secondly, the Court may find it necessary to interpret a municipal law, quite apart from any question of its consistency or inconsistency with international law, simply as a law which governs certain facts, the legal import of which the Court is called upon to appraise'.
24. Anzilotti, *Il diritto internazionale nei giudizi interni* (Bologna, 1905), and *Corso di Diritto Internazionale, Introduzione, Teorie Generali*, vol. I (Padova, 1955), 55–63; see also Ruda, 'The Opinions of Judge Dionisio Anzilotti at the Permanent Court of International Justice', *EJIL* 3 (1992):100 at 102–103, and Gaja, 'Positivism and Dualism in Dionisio Anzilotti', *EJIL* 3 (1992): 123 at 134–138.
25. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration', *BYIL* 74 (2003): 151.
26. *Ibid.*, 153. See, on the differences between international and municipal law, Anzilotti, 'Scritti di diritto internazionale pubblico', in *Trattati generali di diritto internazionale pubblico*, RDI 1 (1906): 45–50; Morelli, *Nozioni di Diritto Internazionale* (Padova, 1967), 68–75; and Gaja, 'Positivism and Dualism di Dionisio Anzilotti', *Eur. J. Int. L.* 3 (1992): 123.

dichotomy between international law and municipal law in the sense that international law would govern relations only between States and municipal law would apply to relationships involving individuals or entities. In his Hague Lectures, predating *Barcelona Traction*, Sereni seemed to have taken a similar approach, rejecting international law as being capable of governing contracts entered into between States or international institutions and foreign investors. Sereni argued that an 'attempt at applying international law to private relations would be tantamount to seeking to apply the matrimonial laws of France or England to relations between cats or dogs'.[27]

However, this rigid separation of municipal law and international law is too categorical to apply to investment treaty disputes, in which the application of international law often requires reference to municipal law. Investment treaty disputes demonstrate municipal law's crucial role in defining the content of the subject matter regulated by the applicable international law standard. The key issue in this context is not which law – municipal law or international – prevails, since there is normally no direct conflict, but how these rules of law should interact. Is there a role for municipal law or should economic realities prevail?

Investment treaties protect foreign investors and their investments by setting an independent international law standard: for example, fair and equitable treatment and prohibition against expropriation without compensation. But international law often does not regulate the right it protects. Therefore, the standard's application should be determined by *renvoi* to municipal law, despite the differences from the diplomatic protection context. The determination of whether a contractual right constitutes an investment requires, first, an enquiry under the relevant municipal law to determine whether the right exists, and any limits to which it may be subject.

The second step is to determine whether this right gives rise to investment protection. The enquiry into the relevant municipal law, however, does not answer the question whether there has been a violation of international law. As the *Vivendi* ad hoc Committee observed, 'a State may breach a treaty without breaching a contract and *vice versa*'.[28] Article 3 of the International Law Commission's (ILC) Articles on State Responsibility further explains 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'.[29]

International law's supremacy in the event of a conflict with municipal law[30] is not the focus of this book. Rather, the central topic is municipal law's role in

27. Sereni, 'International Economic Institutions and the Municipal Law of States', *Recueil des Cours*, (1959): I, 133 at 210. See also Triepel, 'Les rapports entre le droit interne et le droit international', *Recueil des Cours* (1923): I, 77 at 81.
28. *Compañiá de Aguas del Aconquija-Vivendi ('Vivendi')*, Decision on Annulment of 3 Jul. 2002, *ILM* 41 (2002): 1135, para. 95.
29. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (the 'ILC's Articles on State Responsibility') (Cambridge Press, 2005), 86.
30. See, in general, Borchard, 'The Relation between International Law and Municipal Law', *Va. L. Rev. 27* (1940): 137.

providing the substance for concepts such as contracts, property rights, and shareholders' rights, which are relevant in the international investment treaty context but are not regulated under international law.

The question for investment treaty tribunals is how to address, as a matter of international law, an alleged breach of a contract (or other legal obligation concerning an investment) that is regulated by municipal law. There is no self-contained legal system that provides substantive rules of direct applicability for these tribunals. Rather, the applicable rules are identified within a wider juridical context in which rules from other sources, such as customary international law, are integrated through implied incorporation methods or by direct reference. There may be different rules of law, international and municipal, applicable even to the same aspects of a case.

The necessary coexistence of the international and municipal planes is indicated, on the one hand, by the applicability of municipal law to the rights and obligations stemming from an underlying 'investment' contract, and on the other hand by the minimum standards of investment protection in treaties deriving from international law (as well as express treaty provisions).[31] Thus, both municipal law and international law inevitably play roles in investment disputes, and to this extent a general agreement between the parties on applicable law is insufficient: applicable law clauses state the problem without resolving it.[32] Even where the parties have sought to exclude municipal law and have referred exclusively to international law, the latter does not define or regulate contractual or property rights related to an investment. These are in principle governed by the law of the host State (which is also usually the applicable law of the investment contract).[33] Municipal law has a role represented by the definition of the contents of the property rights in dispute.

Economic realities cannot be ignored: the concept of investment implicates economic realities. But is the existence of an economic reality sufficient to trigger the protection of investment treaties? Or, to obtain the benefit from such protection, must the investor have a right in the investment? Judge Gros' Opinion in *Barcelona Traction* deemed economic factors relevant in determining the investment made by the shareholders, as distinct from their legal rights. This triggers the question whether, in the investment treaty context, where international protection is mainly focused on foreign investments, relevance should be given to the 'investment' as a stand-alone concept. Are investors entitled to international protection under investment treaties merely because they have, even indirectly, invested in a foreign State? Is there any requirement of a legal dispute or does the mere existence of damages suffice? In investment treaty disputes, should the quantum phase effectively precede the phase that determines whether a right was violated under international law?

If the application of international law requires a *renvoi* to municipal law, what is the role of international law, given that such a *renvoi* must take into account the

31. See, e.g., *Aguas del Aconquija-Vivendi*.
32. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration', 195.
33. *Ibid.*, 198.

principle that international law governs the characterization of a State act as internationally wrongful?[34] Moreover, there is the preliminary issue of whether the *renvoi* should be to rules generally considered applicable in municipal legal systems, as the ICJ decided in *Barcelona Traction*, or to the rules of a specific State, as Judge Morelli posited. The ICJ's approach has been criticized on the grounds that it does not indicate how the rules of municipal legal systems in general are to be determined.[35] These rules seem to be intended to mean common principles of municipal legal systems, but the concept is vague. If international law does not define certain institutions, the *renvoi* must overcome the absence of those rules – but how can this be accomplished merely by referring to common principles, which in many circumstances will be too general and abstract to apply in the context of a dispute?

On the other hand, a *renvoi* is clearly needed where international law regulates rights that are the subject matter of treaties if international law does not actually contain a substantive definition of such rights. For example, international law does not define property rights, and a definition that disregards the content of municipal law would be an ad hoc (usually post hoc) definition adopted by a tribunal for the purpose of resolving an individual dispute. In such circumstances, there will be no certainty as to the content of the subject matters of investment treaties; investment tribunals will have a broad – arguably too broad – discretion in deciding a dispute. The role, if any, of economic realities becomes a key question for investment treaty tribunals. If municipal law does not consider these realities to be rights, can international law nonetheless protect them?

The chapters that follow analyse the unavoidable interaction of municipal law and international law in investment treaty arbitration. In a number of these arbitrations, the tribunal has struggled with the dichotomy between 'commercial' and 'international' law issues. The underlying problem is that municipal and international law are concerned with the same thing: an investment arising out of a legal relationship that did not exist before municipal law created it. The municipal law of the host State determines whether a right exists and in whom it vests; the investment treaty and public international law establish whether the right is an 'investment' and whether it is subject to the protections afforded by an investment treaty.

3. THREE CATEGORIES OF INTERACTION BETWEEN INTERNATIONAL LAW AND MUNICIPAL LAW

In investment treaty arbitration, the relationship between international law and municipal law can be characterized as falling into three categories. The two categories in which there is unavoidable interaction are explored in this book.

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34. Article 3 of the International Law Commission's Articles on State Responsibility (the 'ILC's Articles on State Responsibility').
35. See Thirlway, 'The Law and Procedure of the International Court of Justice, 1960–1989, Part One', *BYIL* 60 (1989): 1 at 118–125.

3.1. International Law Standing Alone

In the first category, international law is the only applicable law and municipal law has no role to play. The entire dispute is regulated by international law; no reference to municipal law is called for. This category includes, for example, contracts regulated by international law. In the *Eurotunnel* case,[36] a dispute arose under the Treaty of Canterbury (12 February 1986) and associated concession agreement concerning the development of the Channel Tunnel. In 2003 the Eurotunnel Group commenced arbitration against the United Kingdom and France pursuant to an arbitration clause in the concession agreement, alleging damages caused by the governments' failure to protect the tunnels, the terminal areas, and freight facilities from incursions and related delays caused by migrants resident in the nearby Sangatte refugee hostel.[37] The applicable law was the provisions of the Treaty of Canterbury. The concession agreement was defined by the tribunal as a 'free-standing agreement governed by international law'.[38]

This book does not analyse this category, in which there is no interaction between international and municipal law. Moreover, this category is not commonly implicated in investment treaty cases.

3.2. *Renvoi* to Municipal Law

In the second category, international law defines certain concepts, but a *renvoi* to municipal law is necessary for these concepts to apply in the investment protection context. The definition of State organ, for example, belongs to this category. International law defines the term 'organ', but there still must be a *renvoi* to the definition of the same term under municipal law. The *renvoi*, however, does not complete the analysis. As discussed in Chapter 1, it constitutes only the initial step. After the *renvoi* to municipal law, the content of municipal law must be tested against international law. This category also applies for concepts such as 'investment', 'investor's nationality', 'property', and 'shareholders' rights', where there is no international law definition.

A treaty may identify various economic activities and may also refer to the laws and regulations of the host State in relation to the notion of 'investment'. The reference to host State laws and rules may not necessarily be used to define 'investment', but may regulate the validity of the investments that the treaty

36. *The Channel Tunnel Group Limited & France Manche SA v. The Secretary of State for Transport of the Government of the United Kingdom of Great Britain and Northern Ireland and le Ministre de l'équipement, des transports, de l'aménagement du territoire, du tourisme et de la mer du gouvernement de la République Française (Eurotunnel)*, Partial Award dated 30 Jan. 2007, *ILR* 132 (2008): 1.

37. There were further claims based on civil penalties against the Group and the support given by the UK and France to a company operating ferry services in the cross-Channel transport market.

38. *Eurotunnel*, 44, para. 146.