The Role of the Domestic Law of the Host State in Determining the ratione materiae Jurisdiction of Investment Treaty Tribunals: The Partial Revival of the Localisation Theory

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Final Conclusion

1. It is the task of this 'Final Conclusion' to share some thoughts on the essential question of whether the theory of 'localisation' has been revived in the course of the recent developments of investment treaty arbitrations in the light of the studies and findings of Chapters 1-7, and if so, to what extent.
2. It was submitted and shown in this Thesis that, in addition to the provisions of investment treaties themselves, the applicable law to bilateral and multilateral investment treaties is a combination of domestic law and international law with each having its own specific field of application. This Thesis analysed the eventualities in which domestic law is applied in investment treaty arbitrations as 'fact' and as 'law'. It was submitted that whereas domestic law mostly applies as 'fact' in the merits phase of an investment treaty case, when it comes to matters of jurisdiction, in particular, subject-matter jurisdiction, the municipal law of the host state functions as 'law'. With a particular focus on the application of domestic law to issues of subject-matter jurisdiction, this Thesis examined various situations in which domestic law might be applied as 'law', the basis of such application, the modality of the ascertaining the contents of domestic law, and the consequences of the application of domestic law in an investment treaty arbitration proceeding. Furthermore, the more recent roles occupied by the courts of the host state in the resolution of investor-state disputes were also examined in light of the new developments in investment arbitration jurisprudence and the terms of more recent investment treaties. Being mindful of the analyses conducted herein, it has now become clear that through the gradual insertion of local elements (i.e., laws and courts of the host state) into investment treaties and through the developments in investment treaty arbitration practice, nowadays, one can see that investment treaty arbitrations are 'localised' to some extent, meaning that host states have managed to effectively 'relocalise' their legal relationship with foreign investors at least to some degrees. In other words, the host states, in particular through recent developments, have reasserted the control they had lost when their cherished 'localisation' theory was struck by the flood of 'internationalisation' and the fatal hurricane of bilateral investment treaties.
3. Through the analysis carried out in Chapters 1-4 of this Thesis, I was able to draw certain general conclusions. **Firstly**, it was shown in Chapter 1 that, irrespective of the broad formulation of the applicable law clause of the underlying investment treaty, the role of the domestic law of the host state in determining the all-important subject-matter jurisdiction of an investment treaty tribunal is pervasive. Indeed, many of the issues concerning jurisdiction *ratione materiae* have a direct or an indirect link with the laws of the host state.[1] Such matters include the definition and determination of rights comprising investments, the legality of investments, and, in certain cases, the approval for the investment. To elaborate on this point, one leg of the jurisdiction chair is the subject-matter or jurisdiction *ratione materiae*. In order to ascertain jurisdiction *ratione materiae*, an arbitral tribunal, seized of deciding an investment treaty case should have before it a check-list, enlisting at least three items: (1) whether there are rights over assets and properties recognised by the domestic laws of the host state; (2) whether such rights have been validly and legally obtained; and (3) whether such recognised and valid rights under the laws of the host state meet the economic definition of an investment, or

[1] A Newcombe & L Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 95-96 (stating that: "Domestic law questions often arise at the jurisdictional phase of IIA arbitration proceedings, as they are relevant to establishing the existence of the protected investment or the specific disputed contractual or proprietary right, and thus a tribunal's jurisdiction *ratione materiae*.")

the so-called '*Salini* test'.[2] If all the boxes of the check-list are ticked, then the tribunal can make sure that one leg of the chair works properly well. The first two items of the above-mentioned list were subject to detailed discussion in this Thesis. In fact, while the issue of the existence of 'investment' requires an autonomous interpretation and an analysis of economic features, and, as such, warrants a general economic examination, the rest of jurisdiction *ratione materiae* analysis is legal discussions of existence and validity of rights, in which host state law plays the principal role.

I argue that there are two main legal grounds to justify the application of the internal laws of the recipient state for the purpose of identifying rights over properties and specifying the legality or illegality of an investment. It was demonstrated in Chapters 2 & 3 that the domestic law of the host state applies to the above-mentioned topics of subject-matter jurisdiction either because the contracting parties to the investment treaty have expressly or implicitly agreed so or because the nature of the issue requires the application of host state law. In the latter situation, domestic law applies because the matter in question is one which is related to the sovereignty of the host state as to which international law usually, and unless the contracting parties to the investment treaty have agreed otherwise, does not have a rule to apply. In such situations, general principles of law call for the application of domestic law to the matters concerned. In this relation, it was also established in Chapters 2 & 3 that a proper conflict of laws analysis indicates that it is the law of the host state which has the last say on these matters of subject-matter jurisdiction. Besides, it was indicated that due to its significance in settling these two issues, i.e., the creation and existence of rights/interests over properties and assets and the legality of investment, domestic law of the host state plays a prominent role in determining the jurisdiction *ratione materiae* of a tribunal, leaving very little playing field for international law in this respect.[3] Indeed, whilst it is the domestic law of the host state that determines whether valid and enforceable rights exist, the role of international law would be to determine whether such rights are protected by the treaty.[4] Being mindful of these observations, although much will depend on how the case is pleaded in each individual dispute, generally speaking, it is now arguable that domestic law has indeed "frequent centrality to the outcome of the case".[5] In this light, it cannot be argued that, in international disputes, municipal laws function merely as 'facts'.[6]

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[2] As framed, there are other possible criteria set by some investment treaties like obtaining approval for investments, which is not subject to our close examination in this Thesis.

[3] One possible role for international law could be providing lists of limitations, exclusions, and exceptions in the 'definitions' clause of an investment treaty or defining the terms 'property' or 'asset' directly by an agreement in the treaty or through subsequent agreement and/or subsequent practice.

[4] M Sasson, *Substantive Law in Investment Treaty Arbitration: The Unsettled Relationship between International Law and Municipal Law* (Kluwer Law International 2017) 103.

[5] In 2017, Jarrod Hepburn concluded with dismay that "the place of domestic law in [investment treaty] arbitrations has received somewhat less attention, notwithstanding its frequent centrality to the outcome of the case …" J Hepburn, *Domestic Law in International Investment Arbitration* (OUP 2017) 3-4. Additionally, already in 2003, Douglas had observed that: "With disturbing frequency, questions of municipal law relating to aspects of the investment are brushed aside as peripheral or dealt with superficially by tribunals …" Z Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 BYIL 273. See also VC Igbokwe, 'Determination, Interpretation and Application of Substantive Law in Foreign Investment Treaty Arbitrations' (2006) 23(4) J Int'l Arb 287 (characterising the role of the national law of the host state in foreign investment treaty arbitrations as 'vital' and 'enduring'.)

[6] In *Certain German Interests in Polish Upper Silesia*, for instance, the PCIJ held that:

> [f]rom the standpoint of International Law and of the Court which is its organ, municipal laws are merely facts which express the will and constitute the activities of States, in the same manner as do legal decisions or administrative measures.

Surely, one can fairly criticise an opinion that treats local laws as mere 'facts' in investment treaty arbitrations.[7] Furthermore, it is not even accurate to argue that, when applied as law, domestic law "will be confined to certain incidental and preliminary questions".[8] In point of fact, one could firmly say that domestic law applies to a number of preliminary but fundamental questions in an investment treaty arbitration.

4. **Secondly**, Chapters 2 & 3 went through the legal consequences that the application of the host state law can have on the specific *ratione materiae* issues before an investment treaty tribunal and the upshot of such application for the outcome of the whole case. In particular, through these discussions, it was shown that municipal laws of the host state supply the 'substantive aspects' of the rights underlying investments. The substantive aspects include the existence as well as the legality of a property right.[9] Chapters 2 & 3 of the Thesis also dealt thoroughly with the specific *ratione materiae* questions that may turn up in an investment treaty arbitration case and the assistance that can be provided by the domestic law of the host state to resolving such matters. Through this discussion, it was readily apparent that domestic law of the host state has the role and the capability of answering various questions posed by nuanced *ratione materiae* issues.
5. **Finally**, Part I was concluded by outlining the methods of ascertaining the contents of the host state law. As it was set out in Chapter 4, the rulings of the courts of the host state are the prime means for ascertaining the contents of the host state law.
6. Part II of this work commenced its mission by narrating the history, contents, and the fate of the classical 'localisation' theory. This task was carried out by Chapter 5 of the Thesis. There it was discussed that the backbone idea of the 'localisation' theory was that the fate of an investment contract dispute should be decided by the laws and the courts of the host state. Put differently, those who supported the 'localisation' theory

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See *Certain German Interests in Polish Upper Silesia* (*Germany v. Poland*), Judgment, P.C.I.J. Rep. Series A, No. 7, 1926 (25 May 1926) p 19. See also *EnCana Corporation v. Republic of Ecuador,* LCIA Case No. UN3481, UNCITRAL *(formerly EnCana Corporation v. Government of the Republic of Ecuador),* Partial Dissenting Opinion of Horacio A. Grigera Naon, 30 December 2005 [12] (disagreeing with the application of domestic law to the question of the existence of investment and stating that "[…] the local laws, administrative acts and practices and other conduct attributable to the host State at the moment they had the effect of operating the deprivation of property, are *facts* to be freely evaluated by the arbitrators to determine if the foreign investor's entitlement to protection under international law has been infringed at a specific moment in time or not.") *Vladimir Berschader and Moïse Berschader v. The Russian Federation*, SCC Case No. 080/2004, Award, 21 April 2006 [96] (stating that: "The Vienna Convention provides no role for the domestic law of contracting states in the interpretation of international treaties. Therefore, in the instant case, it is clear that Russian national law is of no relevance in this regard. While Russian law may be relevant in establishing certain factual circumstances involved in the merits of the case, it has no role to play in determining the jurisdiction of the Tribunal."); *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, 21 December 2012 [217]-[218] (where the tribunal holds that reference to domestic law in certain jurisdictional areas is for the purpose of determining "a question of fact"); R Jennings & A Watts (eds), *Oppenheim's International Law* (Vol. 1, 9th edn, Longman 1992) 83 (stating that: "From the standpoint of international law, a national law is generally regarded as a fact with reference to which rules of international law have to be applied, rather than as a rule to be applied on the international plane as a rule of law; and insofar as the International Court of Justice is called upon to express an opinion as to the effect of a rule of national law it will do so by treating the matter as a question of fact to be established as such rather than as a question of law to be decided by the court"); G Sacerdoti, 'Investment Arbitration under ICSID and UNCITRAL Rules: Prerequisites, Applicable Law, Review of Awards' (2004) 19(1) ICSID Rev-FILJ 25-26.

[7] M Sasson (n 4) 1-3.

[8] O Spiermann, 'Applicable Law' in P Muchlinski, F Ortino, and C Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 108; C Schreuer, 'Jurisdiction and Applicable Law in Investment Treaty Arbitration' (2014) 1(1) McGill Journal of Dispute Resolution 17 (where he states that in such situations domestic law is "incidentally applied").

[9] M Sasson (n 4) 147.

put forward the viewpoint that the applicable law of foreign investment contracts should be the municipal laws of the host state and that any dispute arising from such contracts should be decided by the courts of the host state. Chapter 5 addressed this theory and described how it was wiped out by the developed countries. This Chapter was concluded by looking into the phenomenon of bilateral investment treaties which were effectively the last terminating effort for the annihilation of the 'localisation' theory.

7. Thereafter, in Chapter 6, it was shown that both the more recent investment treaty arbitration practice, and to some extent, the trends in investment treaty-making attest to the fact that the role of domestic law in investment treaty arbitrations, in particular, in matters concerning jurisdiction *ratione materiae* is nowadays more outstanding and clear. For instance, if one were to consider previous case law which touched upon such matters, one would have most probably faced silence on the role of the host state law by the arbitral tribunal or would have witnessed that the tribunal would have merely alluded to such a role without being elaborative on the point. One reason that could explain the previous approach could be the unfamiliarity of arbitrators with domestic law or their hesitance to vocally apply domestic law in an international dispute. However, if one considers the current practice, one realises that the investment treaty arbitral tribunals are usually more express on this reality and deal with the role of the host state law in a more comprehensive manner. Furthermore, it was argued in Chapter 7 that the more recent practice of investment treaty arbitration as well as the trends in treaty rulemaking attest to the fact that the courts of the host state have nowadays a much more prominent role through interventions and determinations on various matters related directly or indirectly to matters in dispute in investment treaty arbitrations.
8. These developments, taken overall, leave any reasonable bystander with one plain conclusion: The 'localisation' theory has to some extent resurfaced. This is not to suggest that these developments have fully revived the 'localisation' theory. To be sure, one could only strongly argue for a 'partial' revival of the 'localisation' theory. I use the phrase 'revival of the localisation theory' because the new developments have brought back to life the determinative roles of the host state law and host state courts, the two pillars of the 'localisation' theory, in international investment disputes. Furthermore, these determinations by the laws and the courts of the host state are indeed effective and important since, in certain cases, the determination by the laws of the host state, or the courts of the host state for that matter, is the end of the story for a significant part or all of the case. In one of his earlier articles on investment treaty arbitration, Schreuer describes investment arbitration as a 'voyage' by the sea. He warns that before "embarkation, the passengers need to have their passports checked", otherwise, there will be no journey.[10] The arbitral tribunal sets a passport check for investors to ascertain jurisdiction. If the passport is not valid or there is no visa, there will be no journey at all. Assume that the preliminary point in dispute in an investor-state arbitration is whether the contract constituting alleged contractual rights has been validly entered into under the municipal law of the host state. If the answer to this question is in negative, then, as far as the alleged contractual rights in question are concerned, no claim can be upheld. Indeed, even if a given claim is very strong on the merits, for instance, a viable expropriation claim, but the case suffers from the lack of a subject-matter jurisdiction element, like illegality pursuant to the host state law or the non-recognition of the alleged right/interest by the host state law, the claimant's case would still fail. In *Accession Mezzanine v. Hungary*, in spite of the fact that the tribunal had noted and recognised the wrongfulness of the respondent's conduct in the tender process, it

[10] C Schreuer, 'Investment Arbitration - A Voyage of Discovery' (2005) 2(5) TDM 4.

nevertheless dismissed the claimant's case for lack of jurisdiction.[11] For the same reason, in *Alasdair Ross Anderson et al v. Republic of Costa Rica*, the tribunal stated that considering the all-encompassing nature of the respondent's defence, a finding of illegality by the tribunal "would constitute a complete bar to the entire case advanced" by the claimants.[12] Furthermore, it is arguable, and it was shown in this Thesis, that the more the courts of the host state are engaged directly or indirectly in an investment treaty arbitration, the more is the law of the host state engaged (*qui elegit judicem elegit jus*) since courts of the host state are obliged and/or tend to apply their own municipal law. Similarly, the more the laws of the host state are engaged in such arbitrations, the more significant becomes the role of the domestic courts of the host state since the best place to find the actual application and interpretation of host state law is the jurisprudence of host state courts. This mutual effect can be properly named as the synergetic interaction between host state law and host state courts in investment treaty arbitrations. In this sense, the role and the function of the laws and the courts of the host state cannot be under-appreciated any longer.

9. I though use the term 'partial revival' of the 'localisation' theory since the laws and the courts of the host state do not necessarily have a say in every investment treaty arbitration case. As to the role of the courts of the host state, it should be mentioned that some investment treaties include the courts of the host state as an available option for the investor to opt for in the case of an investment treaty dispute. Even certain recent treaties have selected the courts of the host state as the only forum the aggrieved investor can refer to in case of an investment treaty claim. In the first situation, i.e., the availability of the courts of the host state amongst other venues, the investor does not usually opt for the courts of the host state when it has the option of international arbitration available unless the arbitration proceedings are deemed much more expensive, the dispute is not of a massive or sensitive nature, or the courts of the host state are well-equipped to justly and fairly deal with investment treaty disputes. As to the second situation, i.e., the courts of the host state being the only available forum to resolve the dispute, two observations come to mind: firstly, despite the recent developments, such approach in investment treaties is not yet widespread and even remains, arguably, even rare. Secondly, if the investor has an arbitration clause in its contract with the host state, it might try to circumvent the bilateral investment treaty's dispute settlement provision by invoking the arbitration clause of the pertinent contract. Bearing this in mind, the answer to the question of whether the second limb of the 'localisation' theory has been completely revived in the context of investment treaty arbitration is in the negative. On the other hand, the relevant matters in which the laws of the host state have a say should firstly arise in a case so that the laws of the host state could play their role. One could very well imagine a case, and there are many out there, in which there is no question of jurisdiction *ratione materiae* at all. Furthermore, when such matters do arise in a case, there could be other matters within the same case which are governed by international law rather than municipal law.[13] Therefore, because the

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[11] *Accession Mezzanine Capital L.P. and Danubius Kereskedöház Vagyonkezelö Zrt. v. Hungary*, ICSID Case No. ARB/12/3, Award, 17 April 2015 [190], [200].

[12] *Alasdair Ross Anderson et al v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award, 19 May 2010 [43]. See also VC Igbokwe, 'Determination, Interpretation and Application of Substantive Law in Foreign Investment Treaty Arbitrations' (n 5) 268 (stating that "… jurisdictional questions … may bring foreign investment arbitration to *an abrupt end*…") [emphasis added].

[13] See A Newcombe & L Paradell (n 1) 97 (stating that: "Domestic law has a different role depending on the investment allegedly adversely affected and the treaty standard invoked by the claimant. Thus, the scope of the tribunal's duty to apply domestic law varies from case to case.")

matters regulated or affected by the determinations and/or interventions of the laws and courts of the host state are limited and such matters do not necessarily arise in every single case, the more reasonable characterisation of these new developments would be to label them as 'the partial revival of the localisation theory'. All in all, it is reasonably defendable to say that the 'localisation' theory has been partially revived in the field of investment treaty arbitration with the laws and the courts of the host state occupying more decisive areas in the land of investor-state dispute settlement.

10. Although it is always difficult to predict the future, one can only guess that given the recent trends observed in concluding bilateral and multilateral investment treaties by Western and developing countries, the practice of investment treaty arbitrations, as well as the growing importance to respect the sovereignty of states, the role of the domestic laws and national courts of the host state will be more meaningful and more outstanding as time goes by. This is all happening at a time when Western countries are having their second thoughts on the effectiveness and legitimacy of international arbitration as a means for resolving investment treaty disputes. This has apparently concerned some so far as to label these developments as the 'emergence of a 'NEO-NIEO''[14] or "re-statification" of investment dispute settlement.[15] Therefore, the current movement seems to be towards the 'localisation' rather than 'internationalisation'.
11. The strong trend towards 'localisation' when coupled with the current backlash against the legitimacy of investment treaty arbitration could eventually culminate in the total collapse of the investment treaty arbitration system. This, in turn, among other things, may hamper the rule of law in the international economy sphere.
12. To avoid such an outcome, the path forward is to clearly recognise the role of the laws and the courts of the host state in the resolution of investment treaty disputes. This will give substantial comfort to host states. In this way, they would sense that the resolution of investment treaty cases takes place by paying due heed to their laws and judicial systems. In such a scenario, host states would not feel alienated from the system and would appreciate investment treaty arbitral awards more than they do currently.
13. At the same time, it is imperative to regulate the role of these local elements and circumscribe their function in the resolution of investment treaty cases. If this latter exercise is not carried out properly, the local elements will progressively encroach on arbitration and governance of international law on issues of merits and responsibility which may lead either to the total annihilation of the system or its significant alteration.

[14] CN Brower & S Melikian 'We Have Met The Enemy And He Is US!' Is the Industrialized North 'Going South' on Investor–State Arbitration?' (2015) 31(1) Arb Int'l 19–26.

[15] CN Brower & S Blanchard, 'From "Dealing in Virtue" to "Profiting from Injustice": The Case Against "Re-Statification" of Investment Dispute Settlement' (2014) 55 Harvard International Law Journal Online.