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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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Summary

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. This piece of work analysed the eventualities in which domestic law is applied in investment treaty arbitrations as ‘fact’ and as ‘law’. With a particular focus on the application of the domestic law in the all-important and threshold issues of subject-matter jurisdiction, this Thesis examined various situations in which domestic law might be applied as ‘law’ when determining matters concerning jurisdiction *ratione materiae*, the basis of such application, the modality of the ascertaining the contents of domestic law, and the consequences of the application of domestic law to the subject-matter jurisdiction equation of an investment treaty arbitration proceeding. Furthermore, in addition to the focus on the role of domestic law in subject-matter jurisdiction, the more recent significant roles occupied by the courts of the host state in the resolution of investor-state disputes were also examined in this Thesis 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 into investment treaties (i.e., domestic laws and domestic courts) 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.

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 domestic law of the host state in determining many jurisdictional and substantive issues is pervasive. It was also shown that whereas domestic law acts mostly as ‘fact’ in the determination of matters concerning merits, it usually wears its ‘applicable law’ cloak when dealing with matters of jurisdiction, in particular, when addressing the all-important subject-matter jurisdiction of an investment treaty tribunal. Indeed, many of the issues concerning jurisdiction *ratione materiae* have a direct or an indirect link with the laws of the host state. Such matters include the definition and determination of rights comprising investments, the legality of investments, and, in certain cases, the approval of the investment. I also discussed in Chapter 1 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 Chapter 1 of this Thesis that 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 general international law usually does not have a rule to apply. In such situations, absent an agreement by the state contracting parties in the treaty itself or through subsequent agreement or subsequent practice regarding the definition and/or determination of the pertinent matter, general principles of law call for the application of domestic law to the matters concerned. It was also established in

Chapter 1 of this Thesis that a proper conflict of laws analysis indicates that it is usually the law of the host state which has the last say on these matters of subject-matter jurisdiction.

In Chapter 2 of this Thesis, dealing specifically with the question of determining the legality of the investment in accordance with the host state law, I demonstrated that the municipal laws of the host state apply to this question principally because a majority of investment treaties make express or implicit references to the host state laws when determining whether an investment has been made lawfully or not. In addition, I also showed that when the purpose is protecting an investment by international law, general principles of law also require the application of host state laws to the question of the lawfulness of an investment. In this sense, as per general principles of law, investments made in contravention of host state laws are not protected by international law. Therefore, it was said in Chapter 2 that even in circumstances where the underlying investment treaty has no reference to the application of the local laws of the recipient country, the latter laws should determine whether an investment has been made legally. Next, I dealt with the ‘temporal’, ‘formal’, and ‘substantive’ scope of the legality requirement. As to the less controversial ‘temporal’ and ‘formal’ aspects of the legality requirement, I concluded that depending on the formulation of the legality requirement, all the binding and enforceable laws and regulations of the host state in force at the time of establishing the investment shall be considered in the analysis that an investment treaty tribunal should undertake when deciding whether an investment has been made lawfully in accordance with host state laws. Turning to the more challenging question of the ‘substantive’ ambit of the legality requirement, I devoted a lengthy discussion to reviewing relevant investment treaty arbitration practice – which proved to be inconsistent – doctrinal authorities, and treaty interpretation principles, ultimately coming to the conclusion that the ‘substantive’ reach of the legality requirement extends to the fundamental laws of the host state (including its Constitution, its organic laws, and its mandatory laws) as well as its ordinary laws. As to the second group, i.e., ordinary laws, I concluded that the violation of such laws triggers the legality requirement only when these laws are infringed for the purpose of securing the investment or assuring the profitability of the investment. Finally, I addressed the consequences of the application of host state law to the legality requirement, concluding that a finding by an investment treaty tribunal to the effect that an investment has been made in violation of host state laws culminates in dismissing the case for lack of jurisdiction *ratione materiae*.

Next, in Chapter 3, this time analysing another aspect of subject-matter jurisdiction, I dealt with the question of the role of the laws of the host state in determining the creation and existence of rights/interests constituting investments. At the outset, I showed that, unless otherwise agreed in the treaty itself, customary international law has no rules to regulate issues concerning property law. Such issues are, thus, exclusively answered by reference to domestic laws. General principles of law and conflict of laws analyses corroborate this understanding. Indeed, in most cases, a conflict of laws survey ends up in the application of host state law either pursuant to a *lex situs* or a *lex contractus* analysis. In Section One of this Chapter, reference was also made to certain investment treaties which make this point clear, i.e., that the creation and existence of rights/interests underlying investments should be determined by referring to the local laws of the host state. Furthermore, it was shown in that Chapter that if an analysis pursuant to domestic law comes to the conclusion that there did not exist a legally binding and enforceable right/interest at the time of the alleged investment, the investment treaty tribunal should reject the case for want of subject-matter jurisdiction.

Finally, I also examined the various aspects of specific property and contractual law issues that an investment treaty tribunal may come across that are governed by host state law. It was submitted by reference to investment treaty arbitration practice that the laws and the regulations of the host state supply answers to these particular questions, such as definition of property, the conditions of transfer of title, and whether the alleged contractual right is binding and enforceable. Through this discussion, it was readily apparent that although in some areas the general application of host state law is clear, when it comes to the actual application of the domestic law to specific issues of legality and existence of rights underlying the investment, the discussion becomes more nuanced.

Finally, Part I of the Thesis was concluded by outlining the methods of ascertaining the contents of the host state law. As it was set out in Chapter 4, there are various methods for ascertaining the contents of host state law, including the text of the legal provisions of host state law, expert testimony on matters of domestic law, and the rulings of the courts of the host state. It was indicated in this Chapter that amongst all of the possible means, the prime tool for ascertaining the contents of the host state law is the decisions and judicial practices of host state courts.

Bearing in mind the significance of domestic law of the host state in settling certain subject-matter jurisdiction issues as described above, 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 an investment treaty tribunal, leaving very little playing field for international law in this respect.¹ 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.² 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”.³ In this light, it cannot be argued that, in international disputes, municipal laws function merely as ‘facts’.⁴ Surely, one can now

¹ 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.

² M Sasson, *Substantive Law in Investment Treaty Arbitration: The Unsettled Relationship between International Law and Municipal Law* (Kluwer Law International 2017) 103.

³ 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’.)

⁴ 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.

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

fairly criticise an opinion which treats local laws as mere ‘facts’ in investment treaty arbitrations.⁵ Furthermore, it is not even accurate to argue that, when applied as ‘law’, domestic law will be confined to certain incidental and preliminary questions.⁶ 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. In particular, through these discussions, it was shown that domestic law of the host state supplies the ‘substantive aspects’ of the rights underlying investments. The substantive aspects include the existence as well as the legality of a property right.⁷

Part II of this work commenced its mission by narrating the history, contents, and the fate of the classical ‘localisation’ theory. 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 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 of this Thesis 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.

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, and as stated in Chapters 2 and 3 of the Thesis, 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

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] (holding 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.

⁵ M Sasson (n 2) 1-3.

⁶ 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”).

⁷ M Sasson (n 2) 147.

domestic law in an international dispute. However, if one considers the current practice, one realises that 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 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 issues related directly or indirectly to matters in dispute in investment treaty arbitrations. For instance, it was shown that when there is a question about the interpretation of domestic law, investment treaty tribunals tend to refer to the practice and rulings of the courts of the host state in order to determine the meaning and the scope of the term in question. Furthermore, in many instances, a prerequisite of admissibility of the case or finding of a violation of a substantive standard of the investment treaty is that the investor should have had recourse to the local remedies in the first place.

These developments in investment treaty law with regard to the laws and the courts of the host state, 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.⁸ 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 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 nevertheless dismissed the claimant’s case for lack of jurisdiction.⁹ 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”

⁸ C Schreuer, ‘Investment Arbitration - A Voyage of Discovery’ (2005) 2(5) TDM 4.

⁹ *Accession Mezzanine Capital L.P. and Danubius Kereskedőház Vagyongazdálkodási Zrt. v. Hungary*, ICSID Case No. ARB/12/3, Award, 17 April 2015 [190], [200].

by the claimants.¹⁰ 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.

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 *ratione materiae* jurisdiction 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. Therefore, because the 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 defensible 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.

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

¹⁰ *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 Igboke, ‘Determination, Interpretation and Application of Substantive Law in Foreign Investment Treaty Arbitrations’ (n 3) 268 (stating that “... jurisdictional questions ... may bring foreign investment arbitration to an abrupt end...” [emphasis added]).

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’’,¹¹ or ‘re-statification’ of investment dispute settlement.¹² Therefore, the movement seems to be towards the ‘localisation’ rather than ‘internationalisation’.

¹¹ 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.

¹² 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.