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2.6 Applicable Law



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NOTE

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OVERVIEW

This Module gives an overview of the most important legal questions that arise in connection with the applicable law under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention).

The substantive rules of law for solving a dispute are not provided by the ICSID Convention. The Convention grants autonomy to the parties in choosing the law that ought to be applied to solve their dispute. The parties can also allow the tribunal to decide *ex aequo et bono*. In the absence of an agreement, the ICSID Convention designates the host State's law in conjunction with international law as the applicable law. The tribunal may not return a finding of *non liquet* if it is unable to discover appropriate rules of law.

Sometimes, difficulties have arisen in identifying the parties' agreement on choice of law. Questions have also been raised concerning the relationship between international law and domestic law.

The ICSID Convention provides the possibility of annulling awards that do not apply the proper law.

OBJECTIVES

Upon completion of this booklet the reader should be able to:

- Understand the significance of the applicable law in ICSID arbitration.
- Discuss the principle of party autonomy in the choice of law.
- Describe the ways in which the parties may agree on the proper law.
- Define the ICSID Convention's rule on applicable law in the absence of party agreement.
- Analyse the relationship of international and domestic law in ICSID practice.
- Explain the prohibition of *non liquet*.
- Identify the requirements for a decision based on equity rather than law.
- Appreciate the possible consequences of a non-application of the proper law.

1. APPLICABLE LAW: GENERAL APPROACH

Introduction

Arbitration awards are always based on substantive rules of law, applicable to the relationship between the parties. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter the Convention or the ICSID Convention) does not provide those substantive rules. It just establishes a procedural framework for the settlement of disputes.

However, Article 42 of the Convention sets forth a mechanism in accordance with which the tribunal is to select the appropriate rules of law for the particular dispute.

This mechanism combines flexibility with certainty. Flexibility is provided by granting the parties the freedom to choose the applicable law. Certainty is provided by ensuring that, if the parties fail to make that choice, the tribunal will find appropriate rules in order to solve the dispute (the host State's law in conjunction with international law). A finding of *non liquet* by the tribunal is prohibited.

Article 42

Article 42 of ICSID Convention provides:

- (1) *The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.*
- (2) *The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law.*
- (3) *The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute ex aequo et bono if the parties so agree.*

Scope

Article 42 of the Convention only addresses the substantive law to be applied. Matters of procedure are not governed by Article 42.

In fact, Article 44 of the Convention states that the arbitration procedure is

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