THE APPLICABLE LAW TO THE SUBJECT MATTER OF THE DISPUTE IN INTERNATIONAL INVESTMENT LAW ACCORDING TO THE ICSID CONVENTION AND GEORGIAN LAW[1]

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Abstract

International investment law is of particular importance for each country's economic development and Georgia is not an exception in this issue. While discussing international investment law investment dispute settlement should ultimately be considered. The present article deals with the issue of applicable law to the subject matter of the dispute in international investment disputes. The whole article is dedicated to the practical aspects of the determining applicable law. More precisely, Georgian regulations and respective provisions of certain international regulations will be covered. The research is done using a comparative, systemic, logical and analytical method. The use of each method in different parts of the article ensures demonstration of rules existing towards determination of applicable substantive law, which is the purpose of the present article.

Key words: *Applicable Law, Investment Dispute, Private International Law, Conflict of Laws*

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INTRODUCTION

In the modern world it is intensively argued in doctrine that applicable law to the subject matter of the dispute in international investment law is very complicated as the problems arise when disputing parties are foreign investors and host states. There are many practical issues which should be resolved during this process.

The research paper is dedicated to the mentioned issue. Furthermore, the main purpose of the research is to estimate the practical issues related to determining applicable law to the subject matter of the dispute. Consequently, there are two topics covered in the present paper. The first part is related to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. More precisely, there is a detailed analysis of Article 42 of the International Center for Settlement of Investment Disputes (hereafter - ICSID) Convention.

The second part concerns to Georgian law which does not sufficiently satisfy modern trends and requires several amendments regarding determining applicable substantial law. In addition, Georgia has concluded more than twenty Bilateral Investment Treaties (hereafter - BITs) with other countries, which stipulate articles about applicable law. These BIT's are very important legal tools in investment disputes because they stipulate applicable law to the dispute which arises between foreign investor and the host state. Therefore, due to the abovementioned issues this research is very important for Georgia and foreign investors in Georgia as well.

1. ICSID ARBITRATION AND CRITERIA FOR DETERMINING APPLICABLE SUBSTANTIVE LAW ACCORDING THE ICSID CONVENTION

International investment law is one of the most important and practical field. Investment disputes between a foreign investor and the host state represent rather problematic issue. This matter involves determination of applicable substantive law as well.

The present chapter of the research paper points out different international investment acts and international investment practice, which through various methods and principles stipulate applicable substantive law to a dispute. The most widespread one among these principles is "close connection rule," [Begic 2005: 134; Dolzer et al. 2012: 288][2] which is rather commonly used in modern investment disputes.

As a rule, the application of "close connection rule" leads to the applicable law which is the host state's law. The mentioned rule is indeed common to most (national) conflict of laws system [Kjos 2013: 83].[3] Except of "close connection rule," "center of gravity" test is outlined in investment law and practice. It reflects general principles such as *lex loci contractus, lex loci solutionis, lex loci delicti, lex loci actus, lex situs, lex domicilli* principles. Using those principles the applicable law was

[2] For example, in UNCITRAL arbitration Case Wintershall v. Qatar, the arbitration tribunal noted the absence of the agreement on choice of law between the parties. However, it only affirmed that considering the close links of investment product to Qatar the law of Qatar had to be applied.

[3] Applicable substantive law was established according "close connection rule" in case Ministry of Defense and Support for Armed Forces of the Islamic Republic of Iran v Westinghouse Electric corp.

established in one of the cases, which turned out to be the substantive law of the host state.[4]
Most investment treaties do not contain an express choice of law articles. If such choice exists, the situation may broadly be categorized as follows. Almost always the dispute is to be decided in accordance with the provisions of the agreement [Yannaca-Small 2010: 197].

1.1 Article 42(1)[5] of the ICSID Convention

1.1.1 The First Sentence

The ICSID Convention expressly recognizes the parties' general freedom to agree upon the substantive law governing their dispute [Born 2014: 2155]. According to Article 42(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. Article 42 authorizes only the substantive law to be applied and does not deal with procedure [Diehl 2012: 284]. At first glance the rule stipulates very simplified procedure which helps arbitrators to determine the applicable law.
The first sentence of Article 42(1) at the first sight without any problem or question states applicable law determined by the parties. However, there are some issues related to rules on conflict of laws. More precisely, whether the article implies or not that particular country's rules on conflict of laws which ultimately are the part of that county's law.
It is deemed that the parties' agreement on the application law comprises of provisions of conflict of laws, unless the parties expressly agree otherwise [Weiler 2005: 250]. Article 42 is designed to give guidance to the ICSID tribunal in choosing the proper law. The tribunal's first task is to ascertain whether the parties have chosen a system of law or individual rules of law. This choice may extend beyond legal rules *sensu stricto* to principles of equitable justice. Only after determining that there is no agreement on applicable rules of law may the tribunal resort to the residual rule referring it to the law of the host state and to international law [Schreuer 2009: 554].

1.1.2 The Second Sentence

The wording of the second sentence of article 42(1) also clearly demonstrates that both domestic and international law should have a role [Diehl 2012: 284].

[4] Economy Forms Corporation v. Government of the Islamic republic of Iran; Award No. 55-165-1 (13 June 1983).
[5] Article 42 of the ICSID Convention: (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.

Accordingly, the second sentence of Article 42(1) of the ICSID convention may conventionally be divided into two parts. The First one is related to the application of the disputing state's law and the second deals with the international law provisions which from the point of arbitrators are expedient. To consider the given regulation, the result which is on the one hand, caused by applying disputing state's law and on the other hand, by applying international law should be apprised. Although, it should be determined whether the arbitral tribunal should unconditionally apply provisions of international law or the latter should be applied as the supplementary provisions of domestic law. This discussion brings into light the various views expressed as to the role of international law in the context of Article 42(1).

1.1.2.1 Disputing State's Law

In the absence of parties' agreement regarding governing law the law of the disputing state is of essential importance. In such case the dispute should be resolved according the law of the host state. However, if dispute arises investors always try to avoid application of host State's domestic law [Tsertsvadze 2013: 268]. Using the law of the host state may give the state a decisive advantage should a dispute arise, as the laws of the host state may be favourable to the host state vis-à-vis the investor [Diehl 2012: 258].

If investors missed or expressly did not choose governing law then the dispute should be resolved exactly according to the law of the host state. Notwithstanding the simplicity of this issue it should be ascertained whether the application of the law of the host state implies or not the conflict of law rules, which may lead to rules of different state's (non-host state) laws as applicable substantive law.

The views expressed in the legal literature may be highly acceptable, because they regard that in the absence of parties choice of governing law the tribunal should apply host state's and accordingly, disputing state's national law, which includes rules of conflict of laws as well. In certain circumstances the latter may refer to the application of another state's substantive law [Weiler 2005: 250].

1.1.2.2 International Law Provisions

International law provisions with their legal nature hierarchically prevail over the certain country's (for example, Georgian) domestic law. Applicable law in investment disputes always need to draw the strict line between international law and the domestic law of the host state [Tsetsvadze 2013: 272].

Three schools of thought have developed in relation to the proper interpretation of the provision and more generally the appropriate role of host state law in the application of investment treaties. The first approach, advocated by prof. Reisman, posits that international law should be used in only limited circumstances to supplement and occasionally correct host state law: International law plays an important role under article 42(1), but if it is wielded incautiously, it can defeat other parts of this provisions. Where there is a genuine *lacuna* i.e., one for which host state laws does not provide a method for filling the tribunal may turn to international law. In addition international law may perform a corrective function.

However, the contingency for correction must be more than a mere difference between international and host state law [Dugan et al. 2008: 209-210]. Accordingly, application of disputing party's law should be examined with conformity of international law provisions in order to determine whether or not it leads to unjustifiable result [Gaillard 2044: 233]. This approach may be regarded as the vertical approach.

The second view of article 42(1) of the Washington Convention envisions a greater role for international investment disputes, but with host state law remaining the primary source. The interpretation was adopted in some early ICSID cases, which involved contractual disputes. The *ad hoc* committee in *Klockner v. Cameroon* was one of the first tribunals to support this view [Dugan et al. 2008: 210].

According to leading commentators the ICSID tribunals should normally apply the law of the state party [Schreuer et al. 2009: 618-619]. The result of the application of that law should then be tested against international law to ascertain whether the application of the host state law has produced an unfair result. This exercise should not involve any judgment on the validity of the host state's law but may result - in the event of a violation of international law - in the arbitral tribunal refusing to apply the host state's law [Weiler 2005: 253]. Accordingly, Article 42(1) of the Convention authorizes an ICSID tribunal to apply rules of international Law only to fill up lacunae in the applicable domestic law and to ensure precedence to international law norms where the rules of applicable domestic law are in collision with such norms [Dolzer 2012: 292].

The third approach to Washington Convention article 42(1) attributes equal importance to international law and host state law. This interpretation was articulated and adopted by the ad hoc committee in *Wena Hotels* v. *Egypt* [Dugan et al. 2008: 212]. This approach may be regarded as horizontal approach.

In case *Amco v. Indonesia* the arbitral tribunal held that regarding "the law governing the substance of the dispute, under Article 42(1) of the ICSID Convention, if the applicable law was not agreed by the parties and there was no relevant host State laws, international law was applicable; and if there were applicable host State laws they must be checked against international law, which would prevail in case of conflict" [Rayfuse 1993: 387].

In case *Enron Corporation v. Argentina*[6] the tribunal stated that, a discussion of which law governs as between international law and domestic law in Convention proceedings is "theoretical," as Article 42(1) of the ICSID Convention has "provided for a variety of sources, none of which excludes a certain role for another". In that case, the tribunal determined that it would apply domestic law and international law to the extent pertinent and relevant to the decision of the various claims before it.[7]

Therefore, the concept of international law should be deemed as *complementary* to the applicable law in case of *lacunae* and as *corrective* in case that the applicable

[6] Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID, Case No.ARB/01/3, Decision 22 May 2007.

[7] This discussion is outlined in the decision which is rendered against Georgia; see: ICSID Case Nos. ARB/05/18 and ARB 07/15, Ioannis Kardassopoulos and Ron Fuchs v. Georgia, 3 March, 2010.

domestic law would not conform on all points to the principles of international law.[8] Simultaneously, some of the authors deem that "the application of the host country's law should merely be "tested against international law to ascertain whether the application of the host State has produced an unfair result [Bjorklund 2014: 512]. Accordingly, "international law's corrective role would apply only when the host country's law produces an unfair result" [Bjorklund 2014: 512]. There is also the view that international law has a controlling function of domestic applicable law to the extent that there is a collision between such law and fundamental norms of international law embodied in the concept of *jus cogens*.[9]

Moreover, one author espouses an even more restrictive point of view regarding Article 42(1), even if there is a gap in the law of contracting state, "Article 42(1) does not thereupon authorize a Tribunal promptly or automatically to resort to international law" [Bjorklund 2014: 512].

In the light of the above the most acceptable view is that the tribunal is obliged firstly to examine the law of host state and if this law contradicts international law then the latter should be applied. At the same time, there is no unified approach regarding the scope of application of domestic law in the context of dispute resolution.

Eight investment disputes against Georgia have been heard so far. More precisely, four out of eight cases were decided in favour of investor, two of them were discontinued and two of them were resolved through settlement.[10] In one case[11] the tribunal heard the dispute under ICSID Convention rules and discussed the issue regarding applicable substantive law. In this particular case the arbitral tribunal was obliged to interpret the applicable substantive law on the one hand according to Article 42 of the ICSID Convention and Bilateral Investment Treaties and on the other hand, under Georgian law. Moreover, the tribunal made decision under Article 26(6) of Energy Charter Treaty[12], which states that the tribunal should render decision under this Treaty and international law provisions and principles. Accordingly, the tribunal made the decision not only on the basis of the certain country's (Georgia) law but in accordance with international rules as well and the final decision was based exactly on them.

According to the view spread in the legal literature arbitrators considering factual circumstances of each case while applying international law and complex domestic laws are obliged to strike the right balance between them [Tsertsvadze 2013: 273]. While applying international law provisions arbitrators should apply firmly fixed general principles such as, for example, *pacta sunt servanda,* etc. [Weiler 2005: 252].

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[8] Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID, Case ARB/98/4, Decision 8 December 2002.

[9] Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID, Case ARB/98/4, Decision 8 December 2002.

[10] See the following link:
http://investmentpolicyhub.unctad.org/ISDS/CountryCases/77?partyRole=2 (accessed 23 May 2017).

[11] ICSID Case Nos. ARB/05/18 and ARB 07/15, Ioannis Kardassopoulos and Ron Fuchs v. Georgia, 3 March, 2010.

[12] A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.

Further, the view spread in the legal literature is to be accepted regarding broad interpretation of Article 42(1) in contrast to Article 22(1) of Stockholm Chamber of Commerce Arbitration Rules, which states that "Arbitral tribunal shall apply the law or rules of law which it considers to be the most appropriate", without specifically designating the law of the host state or the rules of international law [Yannaca-Small 2010: 201].
In consideration of aforesaid it is rather complicated for arbitrators to strike respect balance regarding applicable law in practice. Also, unlike members of Stockholm Chamber of Commerce, arbitrators under the ICSID Convention are bound by two criteria: host state's domestic law and international law rules [Yannaca-Small 2010: 201].

1.2 Importance of Bilateral Investment Treaties for Determining Applicable Substantive Law

The clauses on applicable law contained in BITs are not uniform. Some of them refer to the host state's law, the BIT itself, special investment agreement and rules of international law [Begic 2005: 27].
One type of the clauses in BIT cover combined choice of law clauses. However, these clauses can be additionally differentiated on the basis of legal sources listed in the BIT provisions. The first type of these clauses refer to the host state's law (including its rules on conflict of laws) to the BIT itself, to the rules and principles of the international law and to any special investment agreement concluded between host state and the investor. An example is a clause on applicable law stipulated in the France/Argentina BIT of 1991, which provides:

Article 8

> The arbitration body shall decide on the basis of the provisions of this agreement, the law of the contracting party which is a party to the dispute – including its conflict of law rules – and the terms of possible specific agreements concluding in relation to the investment, as well as the principles of international law on the subject matter [Begic 2005: 27-28].

One example is a clause on applicable law included in the Sweden-Argentina BIT of 1991, which provides: The arbitration tribunal shall decide in accordance with the provisions of this agreement, the law of the Contracting Party involved in the dispute, including its rules of conflict laws, the terms of any specific agreement concluded in relation to such an investment and the principles of international law [Diehl 2012: 266]. The similar clause is found in Art., 8(3) of Sri Lanka/Egypt BIT of 1996. This BIT provides that:

The arbitral tribunal shall decide in accordance with:
- The provisions of this agreement;
- The national law of the contracting party in whose territory the investment was made and

- Principles of international law [Begic 2005: 28].

This provision does not contain reference to the host state's rules on conflict of law or to an investment agreement concluded between the parties. Consequently, the views expressed in the legal literature which declares that, there is a presumption that only the substantive provisions of the host state's law would apply and that would not have to look in to the host state's own rules on the conflict of laws, may be highly accepted [Begic 2005: 28].
The second type of choice of law clauses contained in BITs refers only to the application of the host state's law. An example is stated in Romania/Sri Lanka BIT of 198, which provides:

> All investments made by the investor of one contracting party in the territory of the other contracting party, shall subject to the agreement, be governed by the laws in force in the territory of the contracting party in which such investments are made [Begic 2005: 29; Diehl 2012: 166-267].

The above mentioned examples of choice of law clauses demonstrate that they are quite different. Although, most of them refer to both domestic and international law, some of these clauses contain.

2. DETERMINATION OF APPLICABLE SUBSTANTIVE LAW UNDER GEORGIAN LAW

2.1 Law Adopted by Georgian Parliamnet

In Georgian reality most of investments contracts concluded between the state and an investor imply agreement regarding applicable substantive law. As a rule, parties expressly agree on governing law which in most cases stipulates Georgian law. For example, the product sharing contracts concluded by the State Agency for Oil and Gas state, that "any arbitral tribunal constituted pursuant to this Contract shall apply the provisions of this Contract as governed and construed according to the Laws of Georgia".
Notwithstanding the fact that most of investment contracts include the express provision related to application of the certain substantive law, there might be some cases where parties missed or decided not to regulate the issue regarding governing law. In such case, as a rule, the absence of choice of law should be filled by legal acts, but Law of Georgia on Promotion and Guarantees of Investment Activity[13] does not regulate this issue. Article 16 of the mentioned law governs the procedure on dispute resolution. This article deals only with the procedure regarding the dispute arisen between the State and an investor and it does not refer to the governing law (in the absence of choice of law). As for the Article 36 of Georgian Law on Arbitration, it should be mentioned that this Article entitles arbitrators with the wide range of possibilities in terms of determining applicable substantive law in the

[13] Law of Georgian Parliament, 29-30/5, 11/12/1996.

absence of parties' choice. More precisely, arbitrators have ability to stipulate applicable law from their point of view and it means that arbitrators are not obliged to use conflict of law or any related rules. One more legal basis for determining of applicable substantive law is Georgian Law on Private International Law. Respective provisions of Article 36 states that in the absence of choice of law a contract shall be subject to the law of the country that is most closely related to it. A contract shall be considered to be most closely related to the country in which a party that had to fulfill an appropriate contractual obligation had a habitual residence or residence of administration when concluding the contract. If the subject of contract is the title to land or land use right, it is considered that the contract is most closely related to the country in which the land is located. So, factually Georgian legislation related to the specific law on investment lacks the regulation regarding determination of applicable substantive law. However, while determining applicable substantive law in the absence of parties' choice arbitrators may refer to Article 36 of Georgian Law on Private International Law.

2.2 The Role of Bilateral Investment Treaties Concluded by Georgia

The number of BITs concluded by Georgia has been increasing. The express provisions in the treaties are rather rare. Generally, the reference is made regarding procedural issues. For example, Article 10 of the Agreement on Investment Protection between Georgia and the Swiss Confederation provides dispute resolution rules applicable for the contracting party and the other contracting party's investor. This clause fully deals with procedural rules for dispute resolution and it does not include any regulation related to applicable substantive law. The same regulation is provided in Article 9 of the Agreement between the Government of Georgia and the Government of the Republic of Finland on the Promotion and Protection of Investments.[14] Both of the above mentioned BITs stipulate that the investment disputes between the host state and foreign investor should be transferred to an international arbitration tribunal such as UNCITRAL or ICSID. According to the legal literature if the investment dispute is submitted to the ICSID arbitral tribunal it will apply Article 42 of ICSID convention to determine the applicable law. However, the tribunal may not be limited to the provisions of Article 42 and may use different rules [Gallagher et al. 2009: 361].

The different regulation is provided in the Agreement between the Government of Georgia and the Government of Republic of Austria on Promotion and Protection of Investments. More precisely, under Article 16 of this agreement "A tribunal established under this Part shall decide the dispute in accordance with this Agreement and applicable rules and principles of international law. Issues in dispute under Article 9 shall be decided, absent other agreement, in accordance with the law of the Contracting Party, party to the dispute, the law governing the authorization or agreement and such rules of international law as maybe applicable". Accordingly, Bilateral Investment Treaty between Georgia and Austria stipulates governing law regarding probable dispute and states that the applicable

[14] The same regulation is given in Article 8 of the Agreement on Investment Protection between Georgia and the Republic of Lithuania.

law may be Bilateral Investment Treaty, international law or the law of the host state. This regulation is similar to the provisions stipulated by the ICSID Convention. For example, if a dispute arises between an Austrian investor and Georgia the tribunal may state Georgian law (including Bilateral Investment Treaty between Georgia and Austria) in accordance with the Bilateral Investment Treaty and the ICSID Convention. Although, as it was mentioned above, if the tribunal stipulates that the result of applying these rules is rather harmful for the investor and Georgian law expressly violates international law principles the tribunal may establish international law provisions as applicable law [Comp. with Bjorklund 2014: 512].

International law provisions as applicable substantive law are established by the Agreement between the Government of the People's Republic of China and the Government of the Republic of Georgia concerning the Encouragement and Reciprocal Protection of Investment. In particular, Article 8(5) of this agreement "the tribunal shall reach its award in accordance with the provisions of this Agreement and the principles of international law recognized by both Contracting Parties".[15] Accordingly, the given regulation under this agreement establishes the possibility to govern the dispute between the investor and the state by international law principles.[16]

2.3 Endangered Existing BITs

As it is known, in June 2014 the European Union (hereinafter - the EU) and Georgia signed an Association Agreement (hereinafter – the AA) which entered into force on July 1 2016. This means that all regulations existing in EU will become mandatory for Georgia in the nearest future. In this term, the Treaty of Lisbon is of a particular importance, as under this agreement the EU has gained an explicit exclusive competence with regard to the Foreign Direct Investment (hereinafter – FDI). However, the very precise meaning of FDI and as a consequence the precise extension of such new EU competence remains unclear [Rovetta 2013: 221].

According to the figures there are nearly 170 BITs between EU Member States (hereinafter – intra-EU BITs). These BITs had been concluded at a time when one or both contracting parties were not yet members of EU [Mariani 2014: 265]. It should be mentioned that Georgia has concluded a number of intra-EU BITs with the states which had not been EU Member States at the time of conclusion of the BITs. As the AA has already entered into the legal force, it appeared that Georgia as the EU Member State is party of intra-EU BITs as well.[17]

On 1 December, 2009, the so-called Lisbon Treaty entered into force. As it was mentioned, it shifts the allocation of competence between the EU and its Member

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[15] Agreement between the Government of the People's Republic of China and the Government of the Republic of Georgia concerning the Encouragement and Reciprocal Protection of Investment 1993, Article 8(5).

[16] Compare with: Agreement Between the Government of the People's Republic of China and the Government of the Republic of Albania concerning the Encouragement and Reciprocal Protection of Investments, Article 8(7).

[17] For example, Agreement between Romania and the Government of the Republic of Georgia concerning the Encouragement and Reciprocal Protection of Investment.

States in the field of FDI towards the EU. This means that under the Lisbon Treaty the EU has an exclusive competence to negotiate and conclude investment treaties with respect to FDI. Member States will lose the competence to negotiate and conclude investment treaties covered by the EU competence. As a result of the given regulation in the Lisbon Treaty intra-EU BITs come under increased scrutiny of the Commission following the European Court of Justice's (hereinafter – ECJ) judgements [Burgstaller 2011: 57].

For a Member State to be a part of EU involves the acceptance of the sovereignty of the EU law over the policy-fields conferred to the Union by the Treaties. According to the primacy principle, EU law takes precedence over national law. In its jurisdictional dimension national courts have the duty to apply EU law and set aside any provisions of national law that may conflict with it, whether enacted before or after the EU provision [Mariani 2014: 267].

To define the exact scope of exclusive competence of EU the meaning of FDI should be stipulated. Unfortunately, neither the Lisbon Treaty nor the Treaty on the Functioning of the European Union (hereinafter – TFEU) define the FDI. Neither was the term defined in the EC Treaty [Burgstaller 2011: 62].

Under the Treaty of Lisbon the EU is competent to conclude comprehensive investment treaties. The competence covers market access, pre- and post establishment standards of treatment, performance requirements, investor-state dispute settlement provisions and the terms of the conditions under which expropriations may take place. Therefore, the EU and its Member States will have to sign and ratify agreements with coverage beyond the exclusive EU competence for FDI [Burgstaller 2011: 66].

If any existing intra-EU BIT or BIT concluded by a Member State with the third country is inconsistent with EU law, under Article 351(2) TFEU (equivalent to Article 307(2) EC) Member States will be under an obligation to terminate these BITs. It is important to note that the Treaty of Lisbon does not contain a provision that would recognize the right of Member States to keep in place their existing agreements [Burgstaller 2011: 67]. Moving to the issue of the areas of a potential conflict between the BIT regime of protection of investments and the EU regime of treatment of cross-border investment within the Union, it is necessary to point out the rights provided to investors according to the BIT regime in order to ascertain whether and to what extent they might be in conflict with the EU regime. BITs provide investors with rights to fair and equitable treatment, to full protection and security and to protection against expropriation. These rights are not *per se* in contrast with the rights protected by EU law, but the problem of incompatibility may arise when a special treatment has been accorded by the host state to an investor by means of BIT concluded before that state joined the EU [Mariani 2014: 276].

The first aim of the European integration has been to merge the markets of the Member States into one market [Mariani 2014: 266]. The elimination of the internal frontiers means that the nationality of natural and legal persons should no longer be significant because in the single market "any discrimination on grounds of nationality shall be prohibited" (Article 18 of TFEU) [Mariani 2014: 267]. Accordingly, the certain priorities given already to the Member States under the BITs should be restricted.

To conclude, under ECJ rulings on the one hand the EU Member States should fulfill their obligations under Article 307 of EC Treaty and should take appropriate step to eliminate incompatibilities of BITs concluded with non-European countries with EU law. On the other hand intra-EU BITs should be terminated on the grounds that they overlap with EU law [Burgstaller 2011].

As it appears from the issues discussed above after joining the EU, Georgia will have to deal with two issues: the first, it should terminate all intra-EU BITs and the second, it should respectively amend all BITs concluded with third stated in order to be in compliance with EU law. As a result under these changes may be discarded provisions of the respective BITs related to the determination of applicable substantive law.

CONCLUSION

In the light of aforesaid, several important issues may be outlined. The first sentence of Article 42(1) stipulates parties' right to choice of applicable substantive law. Although, choice of host state's national law includes conflict of law rules as well which in certain circumstances may refer to the application of another state's substantive law.

The second sentence of Article 42(1) consolidates relation and possibility of application of host state's law and international law provisions. With this in mind, it may be concluded that application of the state's law which is party to the dispute includes its conflict of law rules as well. Moreover, the tribunals are obliged to examine whether the disputing state's law complies with international law provisions and if the latter is violated it will prevail over domestic law.

As for Georgian legislation, it lacks the express regulation regarding determination of applicable substantive law in investment disputes. Namely, Law of Georgia on Promotion and Guarantees of Investment Activity should precisely regulate the issue regarding the governing substantive law. However, there is not any restriction referred to such choice of law. Accordingly, on this basis parties are eligible to choose any country's law as governing law. Although, if parties did not stipulate applicable law it will not able to govern the dispute under Georgian law and additional problem will arise.

As Georgia is a party to the ICSID Convention it means that the mentioned act has full legal force towards Georgia. Further, according Article 7(1) in Law of Georgia on Normative Acts "international agreements and treaties of Georgia are also normative acts of Georgia". Following to Article 7(3) international agreements and treaties of Georgia prevail over organic laws or laws of Georgia. So, when the case is to be resolved under Georgian legislation provisions of the ICSID Convention should be taken into account as well.

Further, taking into consideration the fact that Georgian investment legislation does not exactly state anything regarding applicable law sometimes the latter is determined in Bilateral Investment Treaties. Simultaneously, there are some Bilateral Investment Treaties that lack reference to applicable law but stipulate ICSID rules as applicable to the investment disputes. In such case the ICSID Convention is referred as its Article 42 states applicable substantive law. However,

as it was mentioned above, arbitrators may consider other rules while determining applicable substantive law.

In practice and doctrine two approaches regarding relationship between international law and domestic law are to be pointed out. The vertical approach implies such interpretation of Article 42 of the ICSID Convention that firstly disputing state's law should be applied and then international law. According to horizontal approach, domestic and international have separate places and accordingly, discussion regarding their ordinance is unsubstantiated [Tsertsvadze 2013: 272].

One more important issue is related to the effects of Georgia's association with the EU. As after association EU law becomes prevailing over national law, Georgia may have to terminate all intra-EU BITs and respectively amend all BITs concluded with third stated in order to be in compliance with EU law. This may cause alteration of rules related to the determination of applicable substantive law to the investment disputes stipulated in the BITs.

To conclude, while determining applicable substantive law in investment disputes various factors should be taken into consideration. The loophole in Georgian legislation in the light of growing investment development may be a reason of different practical problems. Accordingly, improving of Georgian legislation, namely Law of Georgia on Promotion and Guarantees of Investment Activity should be set on the agenda.

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