A Debate About the Not So Straightforward Applicability of the Articles on State Responsibility to Investor-State Arbitrations

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At a time when Spain is targeted by investment arbitrations (with almost thirty ICSID cases pending against it), the second ICSID-CIAMEN Forum held in Madrid could not be more auspicious. The event – organized by Marta Lya Martini Briceño and José María Beneyto from the CIAMEN (*Centro Internacional de Arbitraje, Mediación y Negociación*) with the collaboration of Gonzalo Flores (ICSID Deputy Secretary-General) – was hosted at CEU-San Pablo University and gathered arbitration practitioners from a variety of jurisdictions. The hot topics of the Forum were the most recent ICSID jurisprudence, the future amendments to the ICSID Arbitration Rules and Spain's renewable energy cases.

During the conference, a debate about the applicability of the International Law Commission's Articles on State Responsibility (ILC Articles) to investor-state arbitrations struck my attention. This post attempts to report on that debate and add a few observations.

A different view on the ILC Articles

During his presentation, while highlighting diverging interpretations of the FET standard in the recent awards rendered against Spain, Derek Smith (Foley Hoag) expressed the singular view that it is a widespread mistake to apply the full reparation principle – enshrined in Art. 31 of the ILC Articles – when assessing damages in investor-state arbitral proceedings. Although this has been a common practice by many arbitral tribunals, Smith considered it to be an error and argues his position based on the *Chorzów Factory case*, the Commentaries of the ILC to the provisions of the ILC Articles dealing with the legal consequences of an internationally wrongful act of a State, and the stance maintained by Professor James Crawford.

Smith argued that the *Chorzów Factory case* – regarded as the starting point by any investment arbitration tribunal called upon to quantify damages – has been repeatedly misinterpreted to the extent that its application has been overstretched to disputes where an individual is arbitrating against a State. Smith submitted that the *Chorzów Factory case* and the principle of full reparation stemming from it (according to which reparation should wipe out all the consequences of an illegal act and re-establish the *status quo ante*) is applicable exclusively to State-to-State disputes, as in that

case the PCIJ intended to rule solely on the reparation due by one State to another. Smith backed up his argument by referring directly to the 1928 Judgement on the Merits of the *Chorzów Factory case*, where, indeed, the German-Polish Mixed Arbitral Tribunal emphasized that "***Rights or interests of an individual*** *the violation of which rights causes damage* ***are always in a different plane to rights belonging to a State****, which rights may also be infringed by the same act.* ***The damage suffered by an individual is never therefore identical in kind with that which will be suffered by a State****[…]"*. This may find confirmation in another excerpt from that case, where the Mixed Arbitral Tribunal stressed that *"The present dispute is…a dispute between governments and nothing but a dispute between governments. It is very clearly differentiated from an ordinary action for damages, brought by private persons[…]"*.

Smith further supported his view by referring to the Commentaries of the ILC which clarify that Part Two of the ILC Articles – including Art. 31 – "does not apply to obligations of reparation to the extent that these arise towards or are invoked by a person or entity other than a State."[fn]ILC Commentaries, pages 87-88[/fn], and again, that "[t]he articles do not deal with the possibility of the invocation of responsibility by persons or entities other than States, and paragraph 2 [of Art. 33] makes this clear. It will be a matter for the particular primary rule to determine whether and to what extent persons or entities other than States are entitled to invoke responsibility on their own account."[fn]ILC Commentaries, page 95[/fn]

Finally, Smith quoted Professor Crawford who confirms that "the ILC Articles make no attempt to regulate questions of breach between a state and a private party such as a foreign investor. Those rules must be found elsewhere in the corpus of international law, to the extent that they exist at all."[fn]Crawford, "Investment arbitration and the ILC Articles on State Responsibility," (2010), ICSID Review—Foreign Investment Law Journal, Volume 25, Issue 1, page 130[/fn]

From all the above it follows – according to Derek Smith – that to award full reparation to an investor constitutes an excessive and legally unjustified compensation.

The majority view by the other Panelists

At this point, during the conference, other members of the panel replied by affirming that applying the full reparation principle to estimate damages in investment arbitrations cannot be regarded as a mistake.

Pedro Claros (DAC Beachcroft) contended that, as the full reparation principle has been applied in diplomatic protection cases (where a State indeed takes up an individual's claim against another State), it is not bizarre its use by way of analogy – and, therefore, the use of Art. 31 of the ILC Articles – in awarding damages to individuals in non-State-to-State disputes.

At that point Derek Smith rebutted that analogy cannot be used as a basis to justify the application of the full reparation principle to individual vs. State disputes, because arbitral tribunals' jurisprudence is not a source of international law (only the jurisprudence of the ICJ is), according to Article 38 of the Statute of the ICJ. Smith submitted that the application of such a principle (and Part Two of the ILC Articles) to investor-State arbitration require a legal ground other than analogy.

Subsequently, Gabriel Bottini (Uría Menéndez) replied that the Commentaries to the ILC Articles make many references to human rights treaty-based cases, where individuals confront States. By consequence, the application of these Articles to individual vs. State disputes, such as investor-state arbitration, is in line with their scope.

Observations

Although the *Chorzów Factory* Tribunal underlines that it is mandated to adjudicate a dispute between States, as opposed to an ordinary action for damages brought by an individual, still it considers that the calculation of the reparation due to the State could be liquidated on the basis of the actual damages suffered by the individual, whose case was espoused by the Claimant State. [fn]Factory at Chorzów (Merits), Judgment of 13 Sept.1928, page 28[/fn] Accordingly, it was that tribunal to draw a first parallelism between the damages suffered by the individual and the damages suffered by the individual's home-State, thus pointing out a straightforward correlation between the losses incurred by the individual and the claimable amount due from the State as form of full reparation. Consequently, the analogy drawn by Pedro Claros appears well-founded.

Even though, unlike the ICJ, arbitral tribunals supporting the application of the full reparation principle may not be a source of international law, they do contribute to the development of international law, especially by building a *jurisprudence constante*, whose authority resides in its persuasiveness. Apart from their influence, we should not be oblivious to the fact that the members constituting those tribunals are often incumbent or former judges of the ICJ itself[fn]Listen to the interview of Bruno Gelinas-Faucher by Joel Dahlquist on The Arbitration Station[/fn].

As correctly pointed out by Gabriel Bottini, the ILC Commentaries to the ILC Articles draw several examples from human rights cases, i.e. individual vs. State cases. Additionally, the Commentaries make direct reference to the practice of ICSID tribunals (again, individual vs. State cases). They do so particularly with respect to the power of ICSID tribunals to award full reparation as compensation, by covering ongoing and also expected lost profits (as long as non-speculative)[fn]ILC Commentaries at pages 100 (footnote 522), 104 (footnote 566)[/fn] More importantly, the Commentaries draw such a reference with respect to Part Two of the ILC Articles, which purportedly is not meant to be applied to individual vs. State disputes. Could this be an inconsistency in the ILC Commentaries?

Lastly, the *missing* legal ground (other than simply analogy), required by Smith's view in order to apply Art. 31 of the ILC Articles to investor-state arbitrations (and more in general to individual vs. State disputes), could be found in the residual character of the ILC Articles. Quoting Professor Crawford himself: "*The ILC Articles are residual articles and an adjudicator must first look at the treaty under review and see what it says on the subject. If the treaty (such as a BIT) covers the field of the issue at stake, the ILC Articles have no role to play.*"[fn]Crawford, "Investment arbitration and the ILC Articles on State Responsibility," page 131[/fn] The corollary of this, of course, is that if the BIT is silent about the standard of compensation, then Part Two of the ILC Articles should apply (full reparation principle included).

Conclusion

Derek Smith's opinion is intriguing, since it questions something – the applicability to investor-State disputes of Art. 31 of the ILC Articles, together with the principle of full reparation – that is taken for granted and part of well-established tribunals' practice. Such a position may come particularly handy if one's goal is getting a *quantum* reduction as state-appointed counsel. However, confining the full reparation principle only to State-to-State disputes stands at odds with the majority view.