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„Restitution and Compensation
RECONSTRUCTING THE RELATIONSHIP IN INVESTMENT TREATY LAW“[†]

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A. Introduction

Stay or leave? Restitution or compensation? Perhaps in this admittedly simplified way one could sketch strikingly the choice to be made when deciding between the two forms of reparation in investment arbitration. While the restitution of, e.g., unlawfully taken property means continued presence and perhaps retention of business activities in a host State, compensation often opens up the possibility to seek new investment opportunities beyond the borders of the host State.

This paper intends to shed light on the rules governing the abovementioned choice in investment treaty law. Starting point of this elaboration will be the "general" rules governing the consequences of the commitment of an international wrong. These rules are contained in the International Law Commission's ("**ILC**") Articles on Responsibility of States for Internationally Wrongful Acts ("**ASR**" or "**ILC Articles**") and basically mirror customary international law (below **0B**.). Thereafter it will turn to the rules applicable to investment treaties, hereby answering the question of whether and to what extent the "general" rules on the relationship between restitution and compensation are also valid within this specific area of investment treaty law (below **C.**) A review of recent arbitral awards (below **C. I.**) will form the basis for a normative construction of the relationship in investment treaty law (below **C. II.**). This construction will proceed from the assumption that the purposes State parties pursue with the conclusion of investment treaties essentially remain in an inter-State sphere (below **C. II. 1. b. (1)**) and, hence, *substantive* treatment rights in respect of foreign investment accrue to the host State of the investor (below **C. II. 1. b. (2)**). Based on such understanding of the purposes pursued with the conclusion of investment treaties, this paper comes to an end with suggesting to strictly "prioritise" restitution among the forms of reparation available in the area of investment treaty law (below **C. II. 3.**).

B. The Content of the International Responsibility of a State in "General" Public International Law

Once an internationally wrongful act has been committed, questions as to the restoration and future of the legal relationship thereby affected arise.

The obligation breached – the so-called primary obligation – is not affected by the legal consequences of an internationally wrongful act. The responsible or author State is, consequently, bound to the continued duty to perform the (primary) obligation breached. This general rule is stated in Article 29 ASR, which is commonly perceived as reflecting the current situation under customary international law.[1]

Furthermore, there are two general – additional, secondary – obligations of the author State *consequent* upon the commission of an internationally wrongful act. That is, first, the obligation of cessation[2] and non-repetition[3] of the wrongful act, also found in Article 30 ASR. This rule aims at protecting and restoring the ongoing relationships or situations of continuing value and shows that State responsibility is not just backward-looking.[4]

Second, there is the obligation to make full reparation for the injury caused by the internationally wrongful act, whereby injury includes any damage, whether material or moral, caused by the internationally wrongful act. The latter obligation, the obligation to make full reparation, was included by the ILC in Article 31 ASR. This provision was based upon the judgement of the Permanent Court of International Justice ("**PCIJ**") in the *Factory at Chorzow* case[5] where the Court stated:

"It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form."[6]

1 Cf., for the situation under customary international law pre-ASR, e. g. epelka, Les conséquences juridiques du délit en droit international contemporain, 1965, p. 18.

2 Cf. for the distinction of cessation and reparation: Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 39 – 41; Cf. for the distinction between cessation and restitution in kind: idem, para. 48 – 52.

3 Cf., e.g., LaGrand (Germany v. United States of America), Judgement, ICJ Rep. 2001, p. 466, para. 124.

4 Crawford/Olleson, in: Evans (ed.), International Law, 2. ed. 2006, p. 470.

5 Judgement of 13.9.1928, PCIJ Series A, No. 17; for a display of judgements and awards granting non-pecuniary remedies see also Schreuer, Non-Pecuniary Remedies in ICSID Arbitration, 20 Arbitration International 2004, p. 325 et seqq.

6 Judgement of 13.9.1928, PCIJ Series A, No. 17, p. 29.

The Court specified in more detail the content of the obligation *"to make reparation in an adequate form"* as follows:

"…reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."[7]

While the Court in the specific case mentioned only two forms of reparation – i.e. restitution (in kind) (below **I.**) and compensation (below **II.**) – in certain cases, satisfaction[8] – the third form of reparation – may be called for. All those three forms of reparation – either granted separately or in combination – are also reflected in Article 34 ASR. The provision of each of the forms of reparation described in Article 34 ASR is subject to further specification in Articles 35 to 39 ASR. In principle, restitution is the very first remedy to be sought among the three forms of reparation as it most closely conforms to the general rule of the law of responsibility according to which the author State is obliged to "wipe out" all consequences with the view to re-establishing the original situation.[9] This clear legal priority is also reflected in the ILC Articles which allow for compensation in Article 36 (1) ASR only insofar as damages cannot be made good by restitution (below **III.**). Considering the relationship between the forms of reparation Articles 33 and 55 ASR also need to be addressed. The former regulates, *inter alia*, the application of ASR rules on the form of reparation to non-State actors (below **IV.**), the latter refers to *leges speciales* which could replace the ASR rules (below **V.**)

I. Restitution

1. The Breadth of the Concept of Restitution

Turning to the concept of restitution in more detail, one is faced with the problem of definition. Broadly speaking, two different readings of reparation were historically offered in literature. Probably the most common view referred to restitution in kind as re-establishing the *status quo ante*, namely the situation that existed prior to the occurrence of the wrongful act, in order to bring the parties' relationship back to its original state.[10] The other reading was to understand restitution in kind as the establishment or re-establishment of the situation that would exist, or would have existed, if the wrongful act had not been committed.[11]

Arangio-Ruiz, Special Rapporteur of the International Law Commission on State Responsibility, explained the differences between the two readings in his Preliminary Report as follows:

"The two concepts cover different areas. In the first place, it is obvious that the first definition refers, for the purposes of restitutio, to a factual and/or juridical situation which has really existed in the past and has been altered additionally or principally as a consequence of the violation. The second definition refers instead to a theoretical legal/factual state of affairs which at no time has been a part of reality but could presumably be a part of reality if the wrongful act had not interfered in the course of events. [… The first] definition views restitution in kind stricto sensu and per se. It leaves outside the concept of compensation which presumably will be due to the injured party for the loss suffered during the period elapsed during the completion of the wrongful act and thereafter until the time when the remedial action is taken. [The second] definition seems instead […] to absorb into that concept not just the re-establishment of the status quo ante […] but also the integrative compensation. In other words, [the first definition] separates the purely restitutive from the compensatory function of reparation, while [the second one] presents, so to

7 Judgement of 13.9.1928, PCIJ Series A, No. 17, p. 47.

8 Wyler/Papaux, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 623 et seqq.

9 Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 114 - 118. The relationship between restitution and compensation is discussed in detail further below, cf. B. III.

10 E. g. de Visscher, La responsibilité des Etats, Bibliotheca Visseriana, 1924, vol. II, p. 118 ; Verdross, Völkerrecht, 5. ed. 1964, p. 399.

11 E. g. Anzilotti, Cours de droit international, French translation of 3. Italian ed. 1929, p. 526; Strupp, in: Stier-Somlo (ed.), Handbuch des Völkerrechts, vol. III, 1. part, 1920, p. 209.

speak, an 'integrated' concept of restitution in kind within which the restitutive and compensatory elements are fused."[12]

Article 35 ASR adopts the narrower definition which has the advantage of not having to deal with a hypothetic inquiry into what the situation would have been if the wrongful act had not been committed. Applying the narrow definition however does not mean that the injured State is placed in a worse situation. Restitution may of course be completed by compensation.[13]

2. Material and Legal Restitution

For systematic reasons, a distinction can be drawn according to the kind of injury for which reparation is due. Material restitution means that the injury takes the form of material damage proper. Good examples of material restitution would therefore be the restitution of confiscated property, the release of a detained individual, or the restitution of an arrested ship.[14] Legal restitution refers to cases where implementation of restitution involves the modification of a legal situation either within the legal system of the author State or on the international plane. Legal restitution can, thus, require *inter alia* annulling certain national laws or court decisions or even annulling an international treaty.[15]

With regard to legal restitution in the domestic law of the author State an additional point should be addressed in respect of this doctrinal distinction. The distinction between material and legal restitution in the domestic law of the author State "*should be viewed not so much as different remedies but as distinct aspects of one and the same remedy*."[16] This follows from the fact that one can hardly conceive a State effecting restitution which would involve purely material operations. Under the rule of law,

"it is hardly thinkable that the Government responsible for an internationally wrongful act could accomplish any restitution without something 'legal' happening within its system. … [Hence restitution will in any way] be essentially legal […], accompanying or preceding material restitutio."[17]

II. Compensation

Compensation constitutes the second secondary obligation consequent of a breach of a primary obligation in international law, either completing or replacing restitution. Article 36 ASR restates this as follows:

"1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established."

The damage compensated for is the financial harm caused by the breach, established by measuring the difference between the actual financial position resulting from the breach and that which otherwise would have obtained. This assessment of the compensable damage does not only involve a challenging fact-finding mission but a complex

"fact-specific delineation exercise in which the freedoms, rights, and prerogatives of actors in both public and private spheres are defined not only by reference to their competing interests, but in light of

12 Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 67.

13 See further below **B. II.**

14 Cf., e.g. *Temple of Preah Vihear* case, ICJ Rep. 1962, p. 6, p. 36 – 37. For more references see Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 74 - 75.

15 Cf. e.g. *Bryan-Chamorro Treaty* case, Anales de la Corte de Justicia Centroamericana (San José, Costa Rica), vol. VI, Nos. 16 - 18, p. 7 = 11 AJIL (1917), p. 674 et seqq; *Martini* case, United Nations, Reports of International Arbitral Awards, vol. II. p. 975 et seqq; for more references see Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 76.

16 Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 82.

17 Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 80.

additional procedural and governance obligations calculated to raise the standards of conduct of all parties and to secure peaceful enjoyment of property"[18]

Hence, rules and methods may vary depending on whether compensation is sought for personal injury, incidental loss, claims to money, property, business and income-producing assets, or lost profits.[19] In any case, however, the way in which compensation is calculated has a significant impact on public policy and carries the immanent hazard that either ordinary commercial risk or legitimate private rights or market positions respectively are illicitly socialised or public goods or interests are secretly privatised.[20]

III. The Relationship between Restitution and Compensation

The relationship between the two forms of reparation is – at first sight – resolved in a straightforward fashion. What can be described by and large as a codification of customary international law[21], in the absence of an election,[22] pursuant to Article 36 (1) ASR restitution is the primary form of restitution, followed – *to the extent* restitution is impossible or excessively onerous – by compensation (and then, to the extent restitution and compensation are impossible, by satisfaction).[23] What can be drawn from the aforesaid is that the three forms are not mutually exclusive within the context of an award. Apparently, they can be granted either separately or in combination, which can be derived from Article 34 ASR.

Within this hierarchy, restitution is placed first because it most closely conforms to the general rule of the law of responsibility according to which the author State is obliged to "wipe out"[24] all consequences with the view to re-establishing the original situation.[25]

It is, furthermore, claimed that *prioritising* restitution serves the purpose of justifying a specific method of calculating compensation, i.e. compensation must cover both, *damnum emergens* and *lucrum cessans*.[26] Such reasoning is, however, not convincing. It is neither the priority given to restitution nor the concept of restitution itself which would justify such standard of calculation as restitution as embodied in Article 35 ASR – contrary to the view taken in the *Factory of Charzów* case – does not contain "hypothetical elements" of *lucrum cessans* but adopts a narrower definition as stated above. What does justify adopting a standard of compensation including *lucrum cessans* is the general rule of responsibility "to wipe out" all consequences of a wrongful act which indeed contains also "hypothetical elements".

Turning to practice, while courts[27] and – albeit to a lesser extent – tribunals[28] generally affirm the existence of the rule of priority, restitution is granted only very rarely. Within the area of law on the protec-

18 Barker, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 599, p. 603. In respect of interest see: Lauterpacht/Nevill, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 613.

19 Barker, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 599, p. 604 - 610. On the ILC Articles see: Shelton, Righting Wrongs: Reparation in the Articles on State Responsibility, 96 AJIL (2002), p. 833, p. 851 - 863. See in respect of international investment law also: Marboe, Calculation of Compensation and Damages in International Investment Law, 2009; Ripinsky/Williams, Damages in International Investment Law, 2009; For commercial arbitration see: Kantor, Valuation for Arbitration, 2008.

20 Barker, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 599, p. 610.

21 For further references cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 114 et seqq.

22 In this respect, Article 43 paragraph 2 lit. (b) ASR indicates that the injured State invoking the responsibility of another State *"may specify in particular what form reparation should take in accordance with the provisions of part two."*

23 Article 37 (1) reads *"...insofar as it cannot be made good by restitution or compensation"*. Note, however, that the prioritisation of restitution and compensation over satisfaction is hardly supported by international practice. Cf. Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 581.

24 *Factory at Charzów* case, Judgement of 13.9.1928, PCIJ Series A, No. 17, p. 47.

25 Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 114.

26 Cf. Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 585 et seq.

27 *Factory at Charzów* case, Judgement of 13.9.1928, PCIJ Series A, No. 17, p. 48. Further references are found by Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para.116, esp. footnote 243.

28 Cf. *British claims in the Spanish zone of Morocco* case, Decision of 01.5.1925, United Nations, Reports of International Arbitral Awards, vol. II. p. 621 - 625, p. 651 - 742; *Religious Property expropriated by Portugal* case, Decision of 04.9.1920, United Nations, Reports of International Arbitral Awards, vol. I, pp. 7 et seq; *Walter Fletcher Smith* case , United Nations, Reports of International Arbitral Awards, vol. III, p. 856; *Heirs of Lebas de Courmont* case, Decision No. 213 of 21.6.1957 of the Franco-Italian Conciliation Commission, United Nations, Reports of International Arbitral Awards, vol. XIII, p. 764; Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility,

tion of alien property, a survey of the case law in respect of the rule of priority of restitution reveals that its existence is, although confirmed, greeted with some more reluctance and applied equally seldom. The PCIL in its *Factory at Charzów*[29] case again laid down the foundations for subsequent rulings. Arbitral tribunals also followed suit. However, the reference to the *Factory of Charzów* judgement is less common than in juridical practice.[30] In *Texaco v. Libya*[31] and in the *Amoco* case[32] of the Iran-US Claims Tribunal the rule was followed. However, some awards also demonstrate a different attitude, for example the *Walter Fletcher Smith* award, and in particular the *BP v. Libya* award,[33] which contested that the priority rule applied in case of expropriation and unlawful nationalisation.

All in all, the case law seems to confront us with a paradox: the validity of the priority rule being regularly confirmed but restitution granted only infrequently. This appears to be grounded in the fact the State parties either exclude by consensus the form of restitution or the injured party restricts its claim to compensation (**1.**) or restitution is impossible or disproportionate (**2.**).

1. Election

Article 43 (2) lit. (b) ASR indicates that the injured State invoking the responsibility of another State *"may specify in particular what form reparation should take in accordance with the provisions of part two."*[34] Taken literally, in the absence of an agreement between the State parties[35], it appears to be for the injured State party to choose the suitable form of reparation.

However, State practice does not unequivocally embrace that the explicit choice or intentions inferred from unilateral acts adopted by the injured State party throughout the proceedings determine the (only) admissible form of reparation. Except for the situation that the responding State party does not object to an explicit or implicit election amounting to a *solo consensu* agreement between the State parties, the question of whether the reaction of the responding State can fully be ignored by the tribunal appears unsettled.[36] Clearly, the possibility of an election always inherits the possibility of abuse. Nevertheless, two observations should not be disregarded in this respect. It was the respondent State in the first place which inflicted the wrong and it should consequently also bear any negative consequences accruing from this wrong. And, while compensation is always possible and the issue of excessive onerousness may be dealt with within the question of *quantum*, the election of a State party in favour of restitution was interpreted by the tribunals as implicitly entailing a request for compensation or satisfaction whenever restitution was impossible or disproportionate.[37]

2. Possibility and Proportionality

If there is no election, it is for international courts and tribunals to determine the appropriate form of reparation in accordance with international law. As already stated previously, in principle restitution is the very first remedy to be sought. The principle meets, however, its limits, first, in case of factual or material impossibility of restitution (Article 35 lit (a) ASR) and, secondly, in a situation where restitution would constitute an excessive onerousness on the side of the author State (Article 35 lit (b) ASR).

2010, p. 573, p. 585.; Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 116.

29 Judgement of 13.9.1928, PCIJ Series A, No. 17, p. 47.

30 Cf. Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 583.

31 *Texaco v. Libyan Arab Republic*, 17 ILM, p. 1, p. 36, para. 109.

32 *Amoco International Finance Corp. V. Iran*, Partial Award of 14.7.1987, 15 Iran-US CTR, p. 189, p. 246 et seqq.

33 *BP Exploration Co. v. Libyan Arab Republic*, 53 ILR, p. 297, p. 332 - 354.

34 Cf. Germany's election in the *Factory at Charzów* case and Finland's election in the *Passage through the Great Belt* case.

35 Cf. *compromis* in *Aminoil v. Kuweit*, 66 ILR p. 533, *compromis* in *Oberlander and Messenger* case (United States/Mexico) in: Fontaine, Pasicrisie Internationale 1794 - 1900, reprint 1997, p. 558 - 568.

36 Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 112.

37 Cf. *Corfu Chanel* case (United Kingdom v. Albania), Merits, ICJ Rep. 1949, p. 4, p. 35 cited Application of the *Convention for the Prevention and Punishment of the Crime of Genocide* case (Bosnia-Herzegovina v. Serbia), Judgement, para. 463. This is a moderation of the *non ultra petita* rule: Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 578.

The notion of factual or material impossibility does usually not cause much of a problem. An illustrative example would be that the ship to be returned sank and cannot be recovered by any means. In such situations restitution is obviously impossible. Material impossibility covers, though, more complex situations going beyond physical destruction. *The Forests of Central Rhodope* case, for example, demonstrates that partial change of conditions of an illicit expropriated forest coupled with the existence of municipal third party rights to the forest acquired in good faith after the expropriation have a bearing on the possibility of restitution.[38]

Some controversy in the proceedings of the International Law Commission surrounded the question of whether impossibility on the grounds of legal or practical difficulties flowing from the municipal legal[39] system of the author State would constitute a valid plea to evade restitution. With respect to the general rule of non-interference with internal matters of a State it was argued that restitution must be replaced by compensation in case restitution would involve interference in or violation of domestic jurisdiction. In particular, the injured State would be denied restitution where the application of such remedy would entail the annulment or the non-application of legislative provisions, of administrative acts or final judgments within the municipal legal system of the author State.[40]

In the end, impossibility on the grounds of legal (or practical) difficulties flowing from the municipal legal system of the author State was not included in the ASR and, thus, is not covered by Article 35 lit (a) ASR.[41] This is underscored by Article 31 ASR which states:

"The responsible State may not rely on the provisions of its internal law as justification for failure to comply with its obligations under this part."

The approach taken by the ILC in concurrence with prevailing doctrine is that difficulties which a State may encounter within its own legal system in discharging its international obligations are not decisive as a legal justification for failure to discharge such international obligations. Otherwise restitution would practically be almost always impossible as there is hardly any international rule compliance with does not imply some impact on the municipal law of the State bound by the rule.[42]

While, in general, obstacles in municipal law will not lead to impossibility of restitution, this, however, does not mean that there are no foreseeable situations in which compensation would be the more appropriate form of reparation. It is conceivable that legal restitution involves a burden out of proportion to the benefit deriving from that restitution. However, any plea of excessive onerousness on the part of an author State in order to escape a claim of restitution should be the object of strict evaluation on the basis of equity and reasonableness.

As just mentioned, the duty of the author State to provide for restitution is also limited by excessive onerousness or, in other words, by proportionality. This has been confirmed by State practice[43] and is evidenced in Article 35 lit. (b) ASR which states that restitution may not

"involve a burden out of all proportion to the benefit deriving from restitution instead of compensation".

Although the ASR do generally not provide for determination of the form of reparation by the primary obligation breached[44] but the focus is on the nature of injury, under this heading the primary obligation breached may play a role with respect to the form and extent of reparation.[45]

38 Restitution was in the end denied: cf. United Nations, Reports of International Arbitral Awards, vol. III, p. 1405, p. 1432.

39 „Legal impossibility" is perceivable in a situation in which restitution meets obstacles in the UN Charter (cf. Article 103) or other prevailing norms of international law. Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 87.

40 Cf. Riphagen, Second Report of the Special Rapporteur, Yearbook of the International Law Commission 1981, Vol. II (Part One), Document A/CN.4/344 & Corr. 1 & 2, p. 79, para. 156 – 157.

41 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 35, para. 8.

42 Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 90 – 98 with further references.

43 Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 99 et seqq with further references.

44 *Rainbow Warrior* case, United Nations, Reports of International Arbitral Awards, vol. XX, p. 215, para. 111; see also: Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 578. There is, hence, neither reason to differentiate in respect of responsibility deriving from contractual and delicious wrongs [Cf. Stern, Le préjudice dans la théorie de la responsabilité internationale, 1973, p. 13] nor between the breach of peremptory norms and the breach of other rules. Cf. Arangio-Ruiz, Preliminary Report on State Responsibility,

IV. Applicability of the ILC Rules on the Form of Reparation to non-State Actors?

Speaking about the relationship between restitution and compensation, Article 33 ASR is to be addressed, stating in its first paragraph that the obligations mentioned above are essentially owed to States. In respect of non-State actors paragraph 2 of Article 33 ASR provides that the provisions on the content of State responsibility are without prejudice to any right, arising from the international responsibility of a State, which may accrue directly to any person or entity other than a State.

Hence, the ILC Articles on State Responsibility recognize that the primary rule may provide rights for non-State entities. The commentary to Article 33 paragraph 2 adds that in such cases,

"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".[46]

In other words, primary rules creating obligations owed to non-State actors can have their own set of secondary obligations, *inter alia*, on the form of reparation. When this is the case and which secondary rules are to be applied, was intentionally left open by the International Law Commission, therewith avoiding a debate[47] which probably would have prolonged the discussion process within the Commission significantly.

In this context it is also worth glancing at the customary international law governing the treatment of property of aliens and its enforcement by the way of the concept of diplomatic protection. The traditional view in international law [48] – though not undisputed in legal writing[49] –is to perceive individuals and corporate entities as objects of international law. In respect of the protection of alien property this means that rights and obligations exist exclusively between sovereign States. The injured individual is not privy to this legal relationship and he cannot claim the customary international law obligations in his own right.[50]

This position was concisely formulated by the PCIJ in its *Mavrommatis* judgement[51]:

"By taking up the case of one of its subjects and by resorting to diplomatic action or international juridical proceedings on his behalf, a State is in reality asserting its own rights – its rights to ensure, in the person of its subjects, respect for the rules of international law."[52]

Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 113.

45 Probably even broader: Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 34, para. 3; Gray, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 589, p. 594; More restrictive: Kerbrat, in: Parlett/Crawford/Pellet/Olleson (eds.), The Law of International Responsibility, 2010, p. 573, p. 578; cited in support: *Rainbow Warrior* case, United Nations, Reports of International Arbitral Awards, vol. XX, p. 215, para. 111; Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 35, para. 3: *"[I]n certain cases, especially those involving the application of peremptory norms, restitution may be required as an aspect of compliance with the primary rules". Kerbrat* holds, hence, the view that there is neither reason to differentiate in respect of responsibility deriving from contractual and delicious wrongs [Cf. Stern, Le préjudice dans la théorie de la responsabilité internationale, 1973, p. 13] nor between the breach of peremptory norms and the breach of other rules. Cf. Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 and Add. 1 & Corr. 1, p. 6, para. 113.

46 Emphasis added.

47 Cf Arangio-Ruiz, Preliminary Report on State Responsibility, Yearbook of the International Law Commission 1988, Vol. II (Part One), Document A/CN.4/416 & Corr. 1 & 2 & Add. 1 & Corr. 1, p. 6, para. 121, para. 115, citing para. 76 et seqq: *"The practice discussed ... does not seem to justify the identification of special rules concerning the treatment of aliens except in the 'neutral' sense of showing a merely numerical prevalence of cases concerning the treatment of aliens over cases concerning other areas of State responsibility.";* Garcia-Amador, Sixth Report on State Responsibility, Yearbook of the International Law Commission 1961, Vol. II, Document A/CN.4/134 & Add. 1, p. 1, para. 177: *"It would, nevertheless, be feasible and desirable to formulate a number of general principles that have served to limit the extent of reparation or to define more precisely the forms or measures applicable in the case of injuries sustained by aliens."*

48 Janis, Individuals as Subjects of International Law, 17 Cornell Int'l L J 1984, p. 61 et seqq.

49 Opposing: de Vischer, Cours général de droit international public (1954 II), 86 Hague Recueil, 507; see in this respect also Garcia-Amador, Sixth Report on State Responsibility, Yearbook of the International Law Commission 1961, Vol. II, Document A/CN.4/134 & Add. 1, p. 1, para. 176: *"The 'injury' or 'damage' should be considered in terms of the subject in fact harmed — i.e., the alien — and reparation should be considered in terms of its real and only object — i.e., not as reparation 'due to the State', but as reparation due to the individual in whose behalf diplomatic protection is being exercised."*

50 *"Anyone who mistreats a citizen directly offends the State."* Cf. de Vattel, Le droit des gens ou les principes de la loi naturelle, vol. I, 1789, 309.

51 Judgement of 30.8.1924, PCIJ Rep. Series A, No. 2, confirmed and applied in cases before the PCIJ, the ICJ and other international tribunals; for further references refer to Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 165, footnote 67.

Hence, the injury caused to the property of a foreign individual constitutes a "moral injury" to the State to which the individual is attached to by the bond of nationality. The application of Articles 28 ASR et seqq. in case of the violation of the rules on the protection of alien property would, therefore, not be limited by Article 33 ASR.

V. Leges Speciales to the ILC Regime

Article 55 ASR can also have a potential impact on the relationship between restitution and compensation. It provides for the case that States make, *inter alia*, special provisions for the legal consequences of breaches of primary obligations. The ILC Articles on State Responsibility

"do not apply where and to the extent that […] the content or implementation of the international responsibility of a State are governed by special rules of international law."

Hence, a treaty provision may, for example, exclude restitution or change the provisions on the forms of reparation and their hierarchical relationship. If not expressly providing for its relationship with the general rules, the question often arising will be whether the specific treaty provision excludes the general rules or coexists, at least partially. In this situation, it is for the specific rule to establish whether and to what extent the general rules are not to be applied.[53]

C. Investment Treaty Law

After having summarised the situation under "general" public international law we shall now turn to investment treaty law. In a first step of analysis, the operation of the rules on the content of international responsibility and, more particular, on the relationship between restitution and compensation in the context of investment arbitration is brought in focus (below **I.**) Against the background of the conclusions arrived at this paper sets forth a normative construction of the relationship between the two aforementioned forms of reparation in investment treaty law (below **II.**).

I. The Relationship between Restitution and Compensation through the Eyes of Arbitral Tribunals Constituted on the Basis of an Investment Treaty

When looking at the more recent arbitral awards, decisions and orders rendered on the basis of investment treaties, one can observe that the vast majority of them does not discuss – indeed, not even mention – different forms of reparation but turns straight to compensation. This is at first sight somewhat surprising since most investment treaties – NAFTA[54] and the Energy Charter Treaty (**"ECT"**)[55], for example, are notable exceptions – do not set out the content of international responsibility including the forms of preparation and, therefore, apparently leave room for examining the governing rules.

To some extent, this phenomenon might be explained by the fact that claimants frequently ask the tribunal to award compensation only and hence de-elect any other form of reparation. Any reference to Article 43 (2) lit. (b) ASR or any other "justification" for the admissibility of such (de-)election is frequently omitted though. Such modus operandi can perhaps be "explained" by some sort of commercial-arbitration-mindset in which party autonomy constitutes a paramount overarching principle, rendering any further explanation dispensable.

However, even from a public international law point of view there is indeed not much reason to discuss this point in detail in an award as long as the claimant's choice constitutes a valid, especially by the respondent unopposed election. Nevertheless, an election should be made transparent. Remarkable exam-

52 Judgement of 30.8.1924, PCIJ Rep. Series A, No. 2, p. 12; see also Garcia-Amador, Sixth Report on State Responsibility, Yearbook of the International Law Commission 1961, Vol. II, Document A/CN.4/134 & Add. 1, p. 1, para. 41.

53 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 55, para. 1 - 5. As a matter of interpretation, for the *lex specialis* principle to apply the same subject matter must be covered by the two provisions, the one more specific than the other. Furthermore, there must be some actual inconsistency between them or, at least, a discernable intention that one provision shall prevail over the other.

54 See Article 1135 (1) NAFTA; restated below **C. II. 2.**

55 See Article 12 (2) and Article 26 (8) 2. sentence ECT; restated below footnote 124.

ples of awards where an election was discussed are *Duke Energy v. Ecuador*[56], *Rumeli Telekom and Telsim v. Kazakhstan*[57] and *CMS v. Argentina*[58].

In particular the tribunal in the last mentioned case – *CMS v Argentina* – made some effort in this respect. In fact – without any need – it went even further: The tribunal, in some length, discussed customary international law governing reparation including its "restatement" in the Articles on State Responsibility making, *inter alia*, reference to Article 35 ASR and the *Factory of Charzów* case.[59]

The tribunal characterised restitution – in broad accord with general public international law – as

"by far the most reliable choice to make the injured party whole as it aims at the reestablishment of the situation existing prior to the wrongful act".[60]

Without referring to the tests in Article 35 lit. (a) and (b) ASR the tribunal went on stating:

"In a situation such as that characterising this dispute and the complex issues associated with the crisis in Argentina, it would be utterly unrealistic for the Tribunal to order the Respondent to turn back to the regulatory framework existing before the emergency measures were adopted, *nor has this been requested*."[61]

In its further discussion of the possibility of restitution[62], while rejecting the option of re-establishing the regulatory framework existing before the Argentina crisis, the Tribunal, suggested "restitution by negotiation of the parties" in order to rebalance contractual relations between Argentina and the foreign investors as its favoured way of restitution.[63]

While this is certainly not restitution *sensu stricto* as it would not lead to the re-establishment of the *status quo ante*, it appears to be a "mixture" of the obligation to cease the wrongful act as envisaged in Article 30 lit. (a) ASR[64] and a suggestion of conflict resolution by amicable settlement.[65]

Ultimately, the Tribunal ended up awarding compensation as it did not want to let the claimant wait until a settlement had eventually been reached between the parties to the dispute.[66]

The conclusions in respect of the available form of reparation in *CMS v. Argentina* were quickly adopted by some other tribunals dealing also with the aftermaths of the Argentina crisis. In *Enron v. Argentina*, for example, the Tribunal found that the respective bilateral investment treaty ("**BIT**") did not contain any provision on the "standard of reparation". It then continued stating rather cryptically:

"Absent an agreed form of restitution by means of renegotiation of contracts or otherwise, the appropriate standard of reparation under international law is compensation […]".[67]

The reasoning in *Sempra v. Argentina* slightly deviated from that in *CMS v. Argentina*, perhaps acknowledging that "restitution by negotiation" actually does not constitute restitution *sensu stricto*. The Tribunal stated:

"In the absence of restitution *or* agreed renegotiation of contracts *or* other measures of redress, the appropriate standard of reparation under international law is compensation for the losses suffered by the affected party."[68]

Unfortunately, however, the Tribunal did not feel obliged to go into further detail why restitution was – in the words of the Tribunal – "absent".

56 *Duke Energy Electroquil Partners & Electroquil S.A. v. Ecuador*, ICSID Case No. ARB/04/19, Award of 18.8.2008.

57 *Rumeli Telekom A.S. and Telsim Mobil A.S. v. Kazakhstan*, ICSID Case No ARB/05/16, Award of 29.7.2008.

58 *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005.

59 *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 399 - 405.

60 *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 406.

61 [Emphasis added] *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 406.

62 One could ask whether the Tribunal attributed binding force to the Claimant's choice of reparation or whether its statement on impossibility was an *obiter dictum*.

63 *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 407.

64 Cf. *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 245: *"The Government has the duty to redress this abnormal situation, first, by putting an end to what by definition should be a temporary situation, a step that might be adequately taken in the context of the continuing negotiations between the parties, and next by paying compensation for the damage caused."*

65 Cf. *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 407: *"As long as the parties were to agree to **new** terms governing their relations, this would be considered as a form of restitution as both sides to the equation would have accepted that a rebalancing had been achieved."* [Emphasis added]

66 *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award of 12.5.2005, para. 407 - 8.

67 *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Award of 22.5.2007, para. 359. Compare: *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, 14.01.2004, para. 75-81.

68 [Emphasis added] Cf. *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Award of 28.9.2007, para. 401.

In its award in *Nykomb v. Latvia* the tribunal[69] made reference to Articles 34 and 35 ASR and the *Factory of Chorzow case* which would – in the absence of any *lex specialis* – govern the content of State responsibility. The tribunal confirmed that restitution constitutes the primary form of reparation. It stated:

"[E]ven if damage or losses to an investment may be inflicted indirectly through loss-creating actions towards a subsidiary in the country of a Contracting State, restitution must primarily be seen as an appropriate remedy in a situation where the Contracting State has instituted actions directly against the investor."[70]

In the eyes of the tribunal, restitution was conceivable in the case at hand by the way of juridical restitution of provisions of Latvian law ensuring the claimant's right to double tariff for the purchase of electric power or compensation, i.e. the payment of a certain sum of money which the claimant would have received if the contract for purchase of power between the respondent and claimant had been properly executed.

In the end the tribunal opted for compensation with the argument that ultimately it would not matter for the claimant – in any way "only" entitled to a certain sum of money – whether the tribunal ordered legal restitution or compensation.[71]

Certainly, such reasoning is difficult to bring in line with orthodox reasoning on the basis of the general rules on State responsibility. It is hard to say whether the tribunal actually meant that granting restitution in such a case would have been disproportionate and, therefore, went for compensation or that there was no hierarchy among the forms of reparation.

LG&E v. Argentina constitutes a case where the claimants explicitly requested compensation only in case no restitution would be available.[72] Already in its *Decision on Liability* the Tribunal pointed out – though, at that point in time it did not order it – that Argentina was under the principle duty to restore the initial legal framework which existed prior to the crisis. It explained

"… what Argentina should have done, once the state of necessity was over on 26 April 2003. The very following day (27 April), Argentina's obligations were once again effective. Therefore, *Respondent should have re-established the tariff scheme offered to LG&E* or, at least, it should have compensated Claimants for the losses incurred on account of the measures adopted before and after the state of necessity."[73]

Again, it is not fully clear whether the tribunal acted on the assumption that there is a hierarchy among the forms of reparation.

In its final Award the Tribunal became even more cautious and ultimately refused to grant restitution. It held:

"The judicial restitution required in this case would imply modification of the current legal situation by annulling or enacting legislative and administrative measures that make over the effect of the legislation in breach. The Tribunal cannot compel Argentina to do so without *a sentiment of undue interference with its sovereignty*."[74]

While sentiment of arbitrators surely is not a valid reason under public international law to deny a claimant reparation taking the form of restitution, the underlying message is nevertheless clear: as soon as an author State has brought about the wrongful act by legislative or administrative acts, the possibility of restitution is seriously called in question – allegedly due to an illegitimate interference with its sovereignty. In this respect the reasoning also differs from the other Argentina cases mentioned above as the Tribunal in *LG&E v. Argentina* did not – at least not explicitly – look at impossibility or excessive onerousness.

69 *Nykomb Synergetics Technology Holding AB v. Latvia*, Arbitration Institute of the Stockholm Chamber of Commerce, Award of 16.12.2003, Section 5.1.

70 *Nykomb Synergetics Technology Holding AB v. Latvia*, Arbitration Institute of the Stockholm Chamber of Commerce, Award of 16.12.2003, Section 5.1.

71 "*An award obliging the Republic to make payments to Windau in accordance with the Contract would also in effect be equivalent to ordering payment under Contract No. 16/07 [- which would amount to the juridical restitution of the contract -] in the present Treaty arbitration. The Arbitral Tribunal therefore finds the appropriate approach, for the time up to the time of this award, to be an assessment of compensation for the losses or damages inflicted on the Claimant's investments."* Cf. *Nykomb Synergetics Technology Holding AB v. Latvia*, Arbitration Institute of the Stockholm Chamber of Commerce, Award of 16.12.2003, Section 5.1.

72 *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Award of 25.7.2007, para. 32 in connection with footnote 7.

73 [Emphasis added] *LG&E v. Argentina,* ICSID Case No. ARB/02/1, Decision on Liability of 3.10.2006, para. 86; NB: para. 265.

74 [Emphasis added] *LG&E v. Argentina,* ICSID Case No. ARB/02/1, Award of 25.7.2007, para. 87.

The same underlying sovereignty argument – though with references to impossibility and excessive onerousness[75] – can be found in *Occidental v. Ecuador* where the claimants sought provisional measures in relation to Ecuador's termination of a participation contract for the exploration of hydrocarbon reserves. Provisional measures would have amounted to the preservation of rights enjoyed under the participation contract. The Tribunal took the view that it

"is well established that where a State has, in the exercise of its sovereign powers, put an end to a contract or a license, or any other foreign investor's entitlement, specific performance must be deemed legally impossible."[76]

It continued:

"The adequate remedy where an internationally illegal act has been committed is compensation deemed to be equivalent with restitution in kind. Such solution strikes the required balance between the need to protect the foreign investor's right and the right of the host State to claim control over natural resources"[77]

Put in a broader perspective, such calls to revert the priority rule and deny restitution on principle in case a respondent State is required to effect such restitution by some internal legal act are not new. They featured high in the proceedings of the International Law Commission as discussed above.[78]

The last case which shall be mentioned here is the ICSID case *Micula v. Romania* which could turn into a *Nykomb v. Latvia*-type approach to the issue of the relationship between restitution and compensation. In *Micula v. Romania* the investor alleged a breach of investment treaty provisions when Romania dismantled policies or regulations that were deemed by the European Commission to run counter to the terms of European Union ("**EU**") law in the course of the EU accession process. In the case at hand Romania withdrew investment incentives – including exemptions from customs duties and certain taxes – which were contrary to EU State aid law.

In the proceedings the investor asked for "restitution of the legal framework" which had prevailed prior Romania's alignment with the European *acquis communautaire*. Already on the jurisdictional level Romania tried to challenge the claimant's request on the grounds that the tribunal lacked the power to order the restoration of old laws which would breach EU law. However, in its jurisdictional ruling, the tribunal noted that it did not lack such power and would determine the appropriateness of restitution in the merits phase of the proceedings.[79] Looking at the case from the perspective of the Articles on State Responsibility such reasoning appears to be in line with orthodox reasoning.[80]

If one wants to sum up and attempt a rough categorisation of the case law referred to above, one could form two broad groups. The first and larger one comprises all those cases in which the claimant opted for compensation. The validity of such election – when accompanied by some reasoning – was justified by the tribunals by taking recourse to the general law of State responsibility.

The second group relates to those cases where there was no election or an election which referred to the "hierarchy of the forms of reparation". The tribunals equally tried to base their reasoning – more or less closely – on the general rules on State responsibility thereby affirming – in principle – their continuing validity and applicability within the context of investment treaties. However, some awards seem to deviate from the general rules on State responsibility insofar as legal restitution is involved. Decisions display patterns of arguments put forward to restrict or even rule out the admissibility of restitution in favour of compensation as the preferred form of reparation within the context of international responsibility flowing from the breach of an investment treaty. Those overly sovereignty-oriented arguments were previously successfully refuted in the course of the proceedings of the International Law Commission, espe-

75 *Occidental Petroleum Corporation, Occidental Exploration and Production Company v. Ecuador,* ICSID Case No. ARB/06/11, Award of 17.8.2007, para. 75 et seqq.

76 *Occidental Petroleum Corporation, Occidental Exploration and Production Company v. Ecuador,* ICSID Case No. ARB/06/11, Award of 17.8.2007, para. 79.

77 *Occidental Petroleum Corporation, Occidental Exploration and Production Company v. Ecuador*, ICSID Case No. ARB/06/11, Award of 17.8.2007, para. 85.

78 See above **B. III. 2.**

79 2 (8) IA Reporter 2009, 11.5.2009.

80 A completely different question is the one of whether the tribunal lost jurisdiction – partially or in full – on the basis of the Sweden-Romania BIT due to the conclusion of subsequent treaties, i.e. the so-called Europe agreement and the accession agreement to the EU, by the State parties concerned. Cf. for an account of the incompatibility of intra-EU BITs with EU law: Hindelang, Member State BITs - There's Still (Some) Life in the Old Dog Yet - Incompatibility of Existing Member State BITs with EU Law and Possible Remedies, in: Sauvant (ed.), Yearbook on International Investment Law & Policy 2010-2011, forthcoming 2011.

cially by preventing special provisions on foreign investment in respect of reparation to be included in the International Law Commission's Articles on State Responsibility.[81] The critical point in the reasoning of the arbitral awards which display an intent of putting the author State in a more favourable situation is that ultimately it would generally rule out restitution as a the primary form of reparation as any restitution in a State governed by the rule of law would require some sort of legal action within the domestic legal system. It furthermore erodes the general principle that an author State may not rely on internal law in order to justify failure to comply with its obligations.

One final observation should be made: As far as one can see, in the course of the elaboration on the issue of available forms of reparation, none of the examined arbitral awards or decisions discussed the preliminary question of applicability of the Articles on State Responsibility in the context of investment treaties. The issue to whom the substantive rights contained in an investment treaty accrue to was left untouched. No reference was, hence, made to Articles 33 and 55 ASR. Not wanting to overly interpret such treatment of the issue, it nevertheless seems to show that investment tribunals hold the view that the rules – or at least the guiding principles – on the form of reparation matter to investment treaties. The question is though whether those rules apply directly or "indirectly".

II. A Normative Construction of the Relationship between Restitution and Compensation

After having reviewed more recent awards dealing with the form of reparation, in this section we shall turn to a normative construction of the relationship between restitution and compensation. As the ILC Articles on the form of reparation apply directly only to States, the question which has to be answered first in this respect is the one of the applicability of the ILC Articles to investment treaty law, a field significantly characterised by the presence of non-State actors (below **1.**). Another issue to be addressed is that of Article 55 ASR. According to this provision the ILC Articles apply only if investment treaty law does not constitute *lex specialis* (below **2.**). Subsequently, the results gained are summarised and distinct features of the applicable rules on the forms of reparation in the context of investment treaty law are highlighted (below **3.**)

1. The Applicability of the Articles on State Responsibility or: To whom Accrue the Substantive Rights Contained in Investment Treaties?

Article 33 ASR states that Part two of the ILC Articles on State responsibility – including the Articles on the forms of reparation – essentially applies to States only and

"is without prejudice to any right, arising from the international responsibility of a State, which may accrue directly to any person or entity other than a State."

Investment treaties contain, on the one hand, substantive rights, such as the fair and equitable treatment standard, non-discrimination, full protection and security as well as rules on expropriation. On the other, they provide for procedural rights and duties in the form of investor-State (and State-State) arbitration. The crucial question is, hence, to which those rights directly accrue to.

As individuals or corporate entities established under a municipal law ("**investors**") have often accepted offers of State parties contained in investment treaties to submit a dispute to impartial arbitration and have acted in hundreds of investment arbitrations under their names as claimant und party to the dispute, independently conducting proceedings against States, it appears less critical to perceive the *investor* as the *holder of the procedural rights* in the context of an investor-State arbitration.[82] While it is beyond doubt that the direct *beneficiary* of the substantive rights contained in an investment treaty is an investor, the crucial question is whether the investor is the "owner", i.e. the *direct holder* of the substantive rights under an investment treaty or "merely" the "*nominal claimant*" in a dispute over rights ultimately held by his home State. Obviously – recalling Article 33 ASR – the ILC Articles on the form of reparation would only apply *directly* if the investor was to be perceived as a "normative claimant" and the true holder of the rights were the State parties to the investment treaty.

81 See above **B. III. 2.**

82 Spiermann, Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties, 20 Arbitration International 2004, p. 179, p. 185 et seq. For further references see idem, p. 186, footnotes 31, 32.

As mentioned previously, the traditional view in international law is to perceive individuals and corporate entities as objects of international law. According to the *Mavrommatis*-formula rights and obligations in respect of the property of foreign investors exist in the context of the concept of diplomatic protection exclusively between sovereign States.[83] The question which arises is whether the vast network of multi- as well as bilateral investment treaties has changed this position. When glancing at arbitral awards and scholarly writing one quickly notices a considerable disagreement on this point. In the following the two major "theories" are depicted by reference to pertinent arbitral awards (below **a.**) and critically reviewed (below **b.**) against the background of the objective and purpose pursued with the conclusion of investment treaties.

a. Derivative and Direct Rights "Theory"

One view perceives investment treaties as institutionalising and reinforcing the law on the protection of alien property within a modified system of diplomatic protection.[84] The substantive obligations of the treatment of foreign investment contained in investment treaties are owed to the contracting States, just as in customary international law, and those States confer *standing* upon their national investors to enforce such obligations before international arbitral tribunals. Such view has been labelled "derivative (rights) theory".[85]

Such perception is also mirrored in a number of investment tribunal awards, most prominently in *Loewen*, where the NAFTA tribunal stated:

"claimants are permitted for convenience to enforce what are in origin the rights of Party states".[86]

Equally, in the *Archer Daniels* award, the majority of arbitrators concluded in respect of the question of rights contained in NAFTA:

„[T]he proper interpretation of the NAFTA does not substantiate that investors have individual rights as alleged by the Claimants. Nor is the nature of investors' rights under Chapter Eleven comparable with the protections conferred by human rights treaties. Chapter Eleven may share (under Section B [, which refers to the investor-State arbitration mechanism]) with human rights treaties the possibility of granting to non-State actors a procedural right to invoke the responsibility of a sovereign State before an international dispute settlement body. But the fundamental difference between Chapter Eleven of the NAFTA and human rights treaties in this regard is, besides a procedural right of action under Section B, that Chapter Eleven does not provide individual substantive rights for investors, but rather complements the promotion and protection standards of the rules regarding the protection of aliens under customary international law."[87]

Such position has also been taken in unison by all three State parties to NAFTA.[88] The recent statement by Mexico in the *Archer Daniels* proceedings can serve as an example:

[…] [T]he substantive obligations are obligations that each NAFTA Party has assumed vis-à-vis the other Parties. They do not cease to be interstate obligations just because an investor has been granted a right of action. […] [I]nvestment treaties provide a set of obligations which require the State to treat in-

83 See above **B. IV.**

84 Sornarajah, State Responsibility and Bilateral Investment Treaties, 20 J of World Trade L 1986, p. 79, p. 93; Crawford, Retrospect, 96 AJIL 2002, p. 874, p. 888 mentioning it as a possibility, without taking a clear own position though.

85 Cf. for such label Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 163.

86 Loewen v. USA, ICSID Case No. ARB(AF)/98/3, Award of 26.6.2003, para. 233.

87 *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. Mexico*, ICSID Case No ARB(AF)/04/05, Award and Separate Opinion of 26.9.2007, para. 171.

88 Canada in: *The Attorney General of Canada v. S.D. Myers Inc.* Challenge of the Award, Amended Memorandum of Fact and Law of the Applicant, para. 67 (for reference see Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 164, footnote 55): *"The obligations listed in Section A of NAFTA Chapter Eleven are not owed directly to individual investors. Rather, the disputing investor must prove that the NAFTA Party claimed against has breached an obligation owed to another NAFTA Party under Section A and that the investor had incurred loss or damage by reason of or arising out of that breach."*; USA: in its Reply to the Counter-Memorial on Jurisdiction of the Loewen Group, Inc., p. 33 et seq. (for reference see Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 164, footnote 56) *"Mexico is correct that 'the right of direct access conferred by Section B of the NAFTA does not in any way alter the interpretation of the Treaty's substantive rights and obligations, which exist at the international plane between the States inter se.";* Mexico: for reference see Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 164, footnote 362.

vestments of qualified investors in accordance with the standards of the treaty, but […] these obligations are owed only to the State of the investors' nationality."[89]

The opposite view holds that investors are recognised to be in a *direct* legal relationship with the host State and they are given procedural means to enforce their *own* substantial rights.[90] Investment tribunals – equally split over the issue – have lent a voice to such perception. In *Corn Products International v. Mexico*, for example, the arbitral tribunal stated:

"[C]laims [under NAFTA chapter 11] are brought by investors, not by States… In the case of Chapter XI of the NAFTA, the Tribunal considers that the intention of the Parties was to confer substantive rights directly upon investors. That follows from the language used and is confirmed by the fact that Chapter XI confers procedural rights upon them."[91]

b. Critical Appraisal

Arbitral tribunals, in discharging their duty to decide a particular dispute presented to them, frequently chose to limit themselves to some apodictic-style statements in respect of the question of the ownership of the substantive rights contained in investment treaties. This might occasionally convey the impression that the issue can be decided in a clear-cut and straightforward fashion. However, already when looking at the text of investment treaties or – putting it in the words of the tribunal in *Corn Products International v. Mexico* – at the "language used" therein, one encounters problems – similar to those when looking at the text of the WTO agreements[92] – to identify *conclusively* the ultimate holder of the substantive rights contained in investment treaties. Such treaties, furthermore, do not address the status of a tribunal hearing investor-State claims.[93]

It therefore appears that the text in itself, as well as the *travaux préparatoires,* is insufficient to identify conclusively the ultimate holder of the rights contained in investment treaties. An interpretation must consequently focus on the context and on object and purpose of the treaties which can be derived from the overall architecture of the investment treaties (below **(1)**) in order to identify the holder of the substantive rights (below **(2)**).

(1) Object and Purpose: Establishing a Healthy Investment Climate, De-politicisation, and a Legal System Based on the Rule of Law

Which aims do State parties pursue with the conclusion of an investment treaty which contains both, substantive treatment rights in respect of an investment of a foreign investor and procedural means to enforce the aforesaid? In their preamble BITs usually refer to the aim of intensifying economic cooperation, creating favourable conditions for investments, promoting and protecting investments and furthering development and prosperity of the contracting State parties. Thus, the State parties reciprocally promise to create a *long-term and stable investment environment* in their territory for investments made by investors of the

89 *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. Mexico*, ICSID Case No ARB(AF)/04/05, Award and Separate Opinion of 26.9.2007, para. 163-4.

90 Spiermann, Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties, 20 Arbitration International 2004, p. 179, p. 206 et seq; with further references at p. 185, footnote 24, Schwartmann, Private im Wirtschaftsvölkerrecht, 2005, p. 93; In consequence probably also Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 189; summarising the views in German literature Braun, in: Kaushal, et al. (eds.), The Backlash against Investment Arbitration, Proceedings of a Harvard Law School conference, 2009, p. 491, p. 496 et seqq. See also Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 33, para. 4 reads *"Part Two deals with the secondary obligations of States in relation to cessation and reparation, and those obligations may be owed, inter alia, to one or several States or to the international community as a whole. In cases where the primary obligation is owed to a non-State entity, it may be that some procedure is available whereby that entity can invoke the responsibility on its own account and without the intermediation of any State. This is true, for example … in the case of rights under bilateral or regional investment protection agreements."*

91 *Corn Products International, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/04/01 (Additional Facility), Decision on Responsibility of 15.01.2008, para. para. 164 - 165, 167, 176; note also para. 12.; see also *MTD Equity Sdn. Bhd. and MTD Chile S. A. v. Republic of Chile*, ICSID Case No ARB/01/07, Decision on Annulment, 21.3.2007, para. 99.

92 Cf. ECJ, T-174/00 (Biret/Council), ECJ Rep. 2002, p. II-17, para. 61 et seq.; AG Alber in: ECJ, C-93/02 P, ECJ Rep. 2003, p. I-10497, para. 116 - 118; see also Panel Report on United States Sections 301-310 of The Trade Act of 1974, WT /DS152R, para. 7.71-7.92.

93 Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 164, p. 167.

other contracting State party on the basis of the rule of law.[94] In short: they aim at establishing and maintaining a "*healthy investment climate*" in the territory of the respective other State party.[95]

Not conclusive, but certainly notable: the substantive treatment standards in investment treaties are frequently formulated in respect of an investment and not an investor.[96] Hence, there is no clear focus on the investor who is protected in his peaceful enjoyment of his property as in human rights agreements[97] but it appears to be the property to which the legal protection is attached. This regulatory approach seems to be in line with the aforesaid overall aim of erecting and maintaining a healthy investment climate which looks on investment treaties more in terms of regulatory stability and predictability of legal orders and economic development and prosperity of State economies instead of fundamental rights of an individual to be protected from the State.

Two constitutive elements appear to be central to such perception of investment treaties. That is, *first*, the predictability, foreseeability and limitation of the exercise of sovereign powers in respect of the treatment of foreign property which is effectuated in the investment treaties' description of *basic treatment standards* in regard to foreign investment. Those obligations under international law limit the exercise of the host State's regulatory and administrative powers with the consequence that any dispute about those obligations essentially constitutes a public law dispute about the conformity of their exercise.[98] Therefore, the interest of a State party in the application and interpretation of the basic treatment standards in the course of investor-State arbitration goes beyond allowing its nationals to clarify the meaning of law, remitting the parties to privately ordering their affairs. By regulating the interactions of sovereign powers with foreign property within their territory now and in the future,[99] State parties aim at establishing and developing a *legal system* which involves difficult balancing and delineation processes, having impacts which go beyond the individual case, between the common good taking the form of national security, social welfare, the protection of cultural heritage or environmental protection and private interests. It can, thus, be said that investment treaties fulfil

"a governance function in influencing the behaviour of foreign investors, States, and civil society more generally by crafting and concretising international standards of investment protection"[100]

beyond individual investor-State disputes. Viewed from such a perspective one can argue that State parties have (retained) an own, a "*systemic interest"* in the well-functioning of such legal system in a way envisaged by the State parties.[101] Whether, in the context of setting up such a system, the individual investor was sufficiently in the contemplation of States can therefore be doubted with some reason.[102]

Such a rule based system, by definition, to a large extent requires the absence of diplomatic discretion and political arbitration, two properties characteristic to the traditional concept of diplomatic protection. This requirement plays into the hands of the *second* constitutive element for achieving a "healthy invest-

94 Critical in respect of advancement of the rule of law by investment treaties: Van Harten, Five Justifications for Investment Treaties: A Critical Discussion (June 9, 2010). Trade, Law & Development, vol. 2, no. 1, p. 1, 2010, available at SSRN: http://ssrn.com/abstract=1622928.

95 See for this notion in the context of customary international law on foreign investment: Hindelang, Bilateral Investment Treaties, Custom and a Healthy Investment Climate, 5 JWIT 2004, 789 et seqq.

96 Cf., e.g., Article 2 (2) German-Chinese BIT „*Investments ... shall enjoy constant protection and security in the territory of the other Contracting Party.*"; Article 3 (1) German-Chinese BIT *„Investments ... shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party.*"; Article 4 (2) German-Chinese BIT *„Investments ... shall not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting Party (hereinafter referred to as expropriation) except for the public benefit and against compensation."*

97 Cf. Article 1 of Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms as amended by Protocol No. 11 *"Every natural or legal person is entitled to the peaceful enjoyment of his possessions."*

98 Schill, Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator, 23 LJIL 2010, p. 404, p. 410.

99 This future oriented, "systemic interest" of States in investor-State arbitration is highlighted by the generalised and prospective consent to arbitration contained in BITs; quite in contrast to other treaty-based mechanisms providing for investor-State dispute settlement like the United States-Mexican General Claims Commission or the Iran-United States Claims Tribunal where subject matter jurisdiction was more limited and retrospective. Cf. Schill, Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator, 23 LJIL 2010, p. 404, p. 411 as well as footnotes 40, 42.

100 Schill, Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator, 23 LJIL 2010, p. 404, p. 409.

101 Schill, Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator, 23 LJIL 2010, p. 404, p. 408 et seqq, footnote. 25; Idem, p. 408: *„By promoting and protecting foreign investment, enhancing the rule of law, creating employment, and enhancing trade opportunities, in particular in developing countries, investment treaty arbitration assumes a public function in backing up the international order created by international investment treaties."*

102 Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 184.

ment climate" as envisaged by the State parties to the investment treaty: the "de-politicisation" of a possible investment dispute to the extent possible. Pursuing and resolving investment disputes under the concept of diplomatic protection carries with it potential spillover effects into other, unrelated policy areas as the host State in particular will aim at expanding its bargaining powers on the diplomatic stage. It also involves "diplomatic humiliation" by the way of being exposed to a claim in traditional international judicial *fora*, such as the International Court of Justice ("**ICJ**"). If the individual investment dispute is "de-politicised" – i.e. relegated from the diplomatic stage or traditional international judicial *fora* – it helps preventing the individual investment disputes straining general inter-State relations and, in turn, it promotes the intended stability in the economic and non-economic inter-State relations.[103] However, due to the nature of conflict a complete "de-politicisation" remains and, indeed, must remain wishful thinking.[104]

The "de-politicisation" of investment relations was effectuated by nominating the investor, an "international law lightweight" if contrasted with a State, as claimant in a possible arbitration over the basic treatment rights contained in investment treaties.

However, the main concern of the State parties to an investment treaty was not to relieve the individual investor of its home-State-dependence – common to the concept of diplomatic protection in customary law – but to "de-politicise" their *inter-State* bilateral relations. Article 27 (1) ICSID, which reads

"No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute."

can be understood in this sense as a safeguard mechanism for the respondent State – and for the respondent State only – to ensure that a "de-politicised" arbitration is not suddenly politicised by a parallel claim on the basis of the traditional concept of diplomatic protection. Relieving the investor from political negotiations with his home State could therefore be viewed as an unavoidable, not necessarily intended, but by the investor certainly appreciated side-effect of the change of the (nominal) claimant.

(2) The Owner of the Substantive Rights

Having outlined the purposes State parties pursue with the conclusion of an investment treaty, those shall now form the basis for an interpretation of an investment treaty with the view to decide on the question of the ownership of substantive rights. This interpretation is conducted in the spirit of *in dubio mitius*[105]

With that said it appears that the referral of procedural rights on the investor which includes the right of standing as *nominal claimant*[106] in investor-State arbitrations seems to suffice to effectuate all purposes pursued with the conclusion of an investment treaty.

While States are apparently under *no compelling need* to additionally limit their sovereignty by also transferring substantive rights upon individuals, one can in fact even bring forward the argument that such transfer would *run counter to the aims pursued* with the conclusion of investment treaties. It was stated above that State parties hold a "systemic interest" in the well-functioning of the legal system they established to order the interactions of State parties with foreign property. They are, furthermore, interested in possible investment disputes not being needlessly politicised. In light of the aforesaid it is suggested that

103 Shihata, Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA, in: The World Bank in a Changing World, 1991, p. 309 et seqq; Schreuer, The ICSID Convention: A Commentary, 2001, p. 398.

104 Note, for example, the still existing tensions in the German-Philippine bilateral relations due to *Fraport's* expropriated investment in the Philippines: *Fraport AG Frankfurt Airport Services Worldwide v. Philippines*, ICSID Case No. ARB/03/25, Award of 16.8.2007; Decision on Annulment, 23.12.2010 (not public). Despite the (initial) defeat of the investor in an – although not uncontroversial – investment arbitration the *Auswärtiges Amt* (German Federal Foreign Office) declares on its website: *„Die deutsch-philippinischen Wirtschaftsbeziehungen sind jedoch getrübt, nachdem die philippinische Regierung im Dezember 2004 den von einem deutsch-philippinischen Konsortium im Dezember 2002 fertig gestellten neuen internationalen Flughafenterminal Manila enteignet hat; bislang wurde erst eine relativ kleine Anzahlung auf die Enteignungsentschädigung geleistet."* (Auswärtiges Amt, Website, http://www.auswaertiges-amt.de/diplo/de/Laenderinformationen/Philippinen/Bilateral.html, last visited: 02.9.2010).

105 Von Heinegg, in: Ipsen, Völkerrecht, 4. ed. 1999, § 11 mn. 20; see also *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction of 06.8.2003, para. 171: *"The appropriate interpretive approach is the prudential one summed up in the literature as in dubio pars mitior est sequenda, or more tersely, in dubio mitius."*

106 In contrast, the referral of a position of an agent upon the investor would not suffice for the attainment of the aim of "de-politicisation" as this would not change the parties to the dispute. The two State parties would still be claimant and defendant; a situation actually to be avoided.

the State parties have retained means to defend their "systemic interest" they hold if threatened by claims of a normative claimant which runs counter to the purposes pursued with by the investment treaty.

Granting the investor the right of a normative claimant entails the danger of misuse and abuse of the position as he is only driven – and this is by no means understood negatively – by self-interest. For example, a claim could run contrary to the ends pursued with the investment treaty if the true purpose of the claim were not to secure conformity of the exercise of the host State's regulatory and administrative powers with its obligations under international law but to recover loss sustained by bad, illegal or even criminal business practice or loss suffered by obviously legitimate regulatory measures of the host State and if, as a consequence, such a claim were to significantly strain the bilateral relations of the two State parties. Equally, merely bringing claims to pressure a host State to make "illegitimate" concessions by hoping that governments will wish to avoid the negative publicity of being the recipient of investment claims does not serve the ends pursued with the conclusion of an investment treaty but discredits the instruments used to implement those ends.

While it is not just difficult but also unwanted against the background of the aim of "de-politicisation" for a home State to meaningfully intervene *by procedural means* in investor-State arbitration[107] and recourse to the classic procedural enforcement mechanism of diplomatic protection – *cf.* Article 27 (1) ICSID – is usually foreclosed, a workable way of securing its interests in the well-functioning of the system it created appears to be by keeping control over substantive rights.

If the home State of the investor is of the opinion that a claim is ill-founded in the aforesaid manner and if there is the danger that "misdirected" self-interest of an individual would discredit the whole system, then the home State should be able to intervene *on the level of substantive law* in a "systemic interest", recalling that "de- politicisation" was not undertaken in favour of the investor but to the advantage of the bilateral relations of the State parties to the investment treaty. This intervention would take the simple form of a waiver of substantive rights in respect of an individual investor *vis-à-vis* the host State which – without taking recourse to any procedural means – would pull out the rug from under an investor-State arbitration.[108]

Such perception is, though, not shared by those who champion the so-called "direct rights theory". Those who favour perceiving investment treaties as conferring direct substantive rights upon an investor mainly build their argument on the difference between the enforcement of (substantive rights in) investment treaties and the enforcement of the rules on protection of alien property. While the latter are made effective by the way of diplomatic protection, investment treaties have installed investor-State-arbitration mechanisms which heavily rely on elements borrowed from commercial arbitration.

While it is neither possible nor suitable in the context of this paper to discuss the whole of the arguments advanced in favour of the "direct rights theory" in detail, in the following three major arguments relating to the applicable law in investment arbitration (below **(a)**), to the non-applicability of the doctrines of continuous nationality and effective/genuine link (below **(b)**), and to the non-applicability of the exhaustion of local remedies rule (below **(c)**) shall be addressed in all necessary brevity. Those arguments allegedly evidence that

"the national State of the investor retains no interest in an investment treaty arbitration instituted against another contracting State".[109]

(a) The Applicable Law

Public international law governs diplomatic protection claims in State-State adjudication. The situation in investor-State-arbitration is less clear: if an investor opts for an arbitration administered by rules designed for commercial disputes, such as the rules of the International Chamber of Commerce ("**ICC**"), the

107 A certain exception in this respect constitutes Article 1128 NAFTA and BITs on the basis of the 2004 US Model BIT (*cf.* Article 28 (2)). Notable is also the US submission in 2008 on the interpretation of Articles 53 and 54 ICSID in the *Siemens v. Argentina* annulment proceeding. The submission relied on the *amicus curiae* authority provided under the recently adopted Article 37 (2) of the ICSID Arbitration Rules, as well as on the authority under Article 44 ICSID to accept *amicus* submissions found under prior ICSID practice in the event that the new arbitration rules were not applicable to that proceeding.

108 See for an outline of consequences of the differing perceptions on the issue of the holder of substantive rights in investment treaties: Bjorklund, Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working, 59 HASTINGS L.J. 2007, p. 241, p. 263–70. See also Roberts, Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States, 104 AJIL 2010, p. 179, p. 184 et seqq.

109 Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 170.

United Nations Commission on International Trade Law ("**UNCITRAL**") or the Stockholm Chamber of Commerce ("**SCC**"), the ultimately governing law – the *lex arbitri* – is the municipal law of the seat of arbitration. Some draw from that that

"[i]f an investor was in essence bringing a claim on behalf of its national State, the logical consequence would be that public international law would govern the arbitration by default as the rights of the two States under an international treaty would be the ratione materiae of the dispute."[110]

While it is certainly correct to perceive public international law as default law in case of investment disputes, this paper however submits that States in their sovereign capacity deviated from this default rule by the way of allowing for the use of commercial arbitration bodies with their choice of law clauses contained in their arbitration rules. Although it might look peculiar turning – figuratively speaking – the hierarchy of norms upside down and although one may identify good reasons to perceive commercial arbitration bodies as ill-fitting with the public law nature of investment arbitration, States are free to resolve their disputes by the law they deem suitable. Whether one can draw the conclusion from an (implicit) choice of law made by the State parties to an investment treaty that

"the general application of municipal law of the seat of arbitration to investment treaty arbitrations once again refutes the derivative theory for investment treaty claims"

remains therefore doubtful. It is not just that an investor-State dispute is rarely resolved by complete neglect of public international law, but also the logical deduction of the holder of a right from the question of applicable law appears not compelling.

(b) Doctrines of Continuous Nationality and Effective/Genuine Link

In contrast to diplomatic protection investment treaty arbitration does not seem overly anxious avoiding forum shopping and competing claims by way of claims based on indirect holdings; hence the doctrines of continuous nationality and effective/genuine link do not play a significant role. Does this imply that a home State has lost its interest in investment claims just because they can be brought by investors which do not unfold significant business activities in a home State's territory?[111] Indeed, the degree of interest of the home State of an investor in a claim against a host State may vary depending on the nature and extent of the business activities of the investor in the home State and the consequential contributions to the community. However, it can be doubted that the home State completely lost its interest in such claims. Again, it is suggested that the home State holds a "systemic interest": each well-founded claim of an investor reinforces and strengthens the rule of law in bilateral investment relations and ultimately furthers an overall healthy investment climate for all investors of the home State in the host State's territory. Moreover, the possibility of forum shopping and competing claims, originating from a broad definition of BIT protected investments, might be owed to the desire to protect indirect shareholdings better by overcoming the *Barcelona Traction*[112] and *Diallo*[113] rulings which by and large advocated a test of incorporation and, therefore, foreclosed indirect claims by shareholders.

(c) The Exhaustion of Local Remedies Rule

Before a diplomatic protection claim can be brought on behalf of a national, the national needs to exhaust local remedies in order to give the host State the chance to redress the wrongdoing by its own means, within the framework of its own domestic legal system.[114] This serves not just the interests of the host but also of the home State of the national. Conflicts on the level of the individual with its host State are prevented from being transformed too quickly into an international dispute between two States.[115]

Without a special provision in an investment treaty, investment tribunals do not require an investor to exhaust local remedies before bringing his case.[116] This allegedly shows that

110 Idem., p. 178.
111 Arguing in such direction: Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 175.
112 *Barcelona Traction, Light and Power Company, Limited*, Judgment, ICJ Reports 1970, p. 3.
113 *Ahmadou Sadio Diallo* (Republic of Guinea v. Democratic Republic of the Congo), Judgement (Preliminary Objections) of 24.5.2007, para. 86 et seqq.
114 Cf. *Interhandel Case*, Judgment, I.C.J . Reports 1959, p. 6, p. 27.
115 McNair, International Law Opinions, vol. 2, 1956, p. 197.
116 Cf. Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 179, footnote 145.

"[b]y dispensing with the local remedies rule as a procedural requirement for the investor's treaty claims, the contracting States have also abandoned their interests that are protected by the rules. If they had a legal interest at stake in an investment treaty claim then this would be a surprising concession."[117]

This conclusion, however, appears not compelling. The home State's interest – i.e. avoiding the politicisation of an investment dispute as long as possible – in the context of an investment treaty is by far better served by the fact that the investor has taken over the role of the nominative claimant. Viewed from this perspective, the local remedies rule has become superfluous. Also from the perspective of the host State, compromising the local remedies rule might not at all be a surprising concession but the prize to be paid for the attraction of investment.

c. Summary so far

After having glanced at some major arguments in favour of a "direct rights theory" it can be doubted that

"[t]he fundamental assumption underlying the investment treaty regime is clearly that the investor is bringing a cause of action upon the vindication of its own rights rather than those of its national State."[118]

The state of play, it is respectfully submitted, is neither clear nor is there – as of yet – any assumption in respect of the holder of the substantive rights contained in an investment treaty which deserves to be labelled fundamental. The purpose of the preceding discussion was to demonstrate that a prudent teleological interpretation of investment treaties in the spirit of *in dubio mitius* also allows for a conclusion that the State parties did *not* confer substantive rights on the investor in order to effectuate their purposes pursued with the conclusion of an investment treaty; rather the referral of procedural rights seems to suffice to meet their ends.

Much confusion results from the recourse in investment treaties to commercial arbitration-type adjudication which also leads to the peculiar choice of law by the State parties to the investment treaty which partially turned – figuratively speaking – the conventional hierarchy of norms upside down. The question of whether this regulatory approach justifies the conclusion that the State parties intended to create a system fundamentally different from the one of diplomatic protection with which the rules on protection of alien property are enforced remains open. It is not unlikely that State parties employed such mechanisms due to of a lack of alternative or/and practicability considerations and otherwise wanted to remain in the "old order of things".

Tying in with *Douglas'* observation that "[i]n deciding between the competing 'derivative' and 'direct' theories, the starting point must be that international legal theory allows for both possibilities"[119], the author of this paper would add that not just legal theory but also practice currently allows for both conclusions.

Coming back to the starting point of this section, i.e. the question of whether Part two of the ILC Articles on State Responsibility – including those Articles on the forms of reparation – also apply in the context of investment treaties: for the purpose of the subsequent discussion, this paper proceeds from the assumption that the question can be answered in the affirmative in respect of the substantive rights flowing from investment agreements. Such conclusion seems to be justified against the background of an *in dubio mitius* interpretation which implies that the aims attached to investment agreements can be (better) achieved if substantive rights remain with the States.

2. Investment Treaty Law as a Subsystem within the Meaning of Article 55 ILC?

As explained in detail above,[120] Article 55 ASR provides for the case that States, when defining the primary obligations that apply between them, also make special provision for the legal consequences of breaches of these obligations or for determining whether there has been such a breach. In such a case the ILC Articles do not apply to the extent that the conditions for the existence of an internationally wrongful act or its legal consequences are determined by special rules of international law. However, except when

117 Idem., p. 179.
118 Idem., p. 182; but see also Idem, p. 184.
119 Idem., p. 168.
120 See **B. V.**

explicitly provided for, controversy sparks off the question of whether the specific provision is to coexist with or exclude the general rule that would otherwise apply.[121]

Those who hold that investment treaties confer substantive rights upon individuals also argue – most likely in the sense of a "moreover-argument"[122] – that Article 55 ILC must apply as the ILC Articles are preoccupied with the consequences flowing from the breach of inter-State obligations and, hence, *"[t]he sub-system created by investment treaties is by definition sui generis"*.[123]

As this paper however proceeds from a different assumption in respect of the holder of substantive rights, there is no room for a "general sub-system created by investment treaties" and, hence, Article 55 ASR does generally not apply in the case of investment treaties as they rarely contain secondary rules. One notable exception[124] in respect of the content of international responsibility constitutes Article 1135 (1) NAFTA which states:

"Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:

(a) monetary damages and any applicable interest;

(b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution".

3. Appreciation

The previous discussion revealed that there is sufficient reason to argue that the ILC Articles on State Responsibility *directly* apply to breaches of substantive obligations contained in investment treaties. Turning to the rules on the forms of reparation their validity in the context of investment treaties is additionally confirmed by and large by arbitral practice. Some arbitral rulings, however, question the general rule of prioritising restitution in case the legal order of the author State causes obstacles. Such interpretation, as explained above, is hardly reconcilable with the general principle that States may not rely on internal law to justify the failure to comply with international obligations.

Apart from that, in the area of investment treaty law restitution constitutes – like in the ambit of general public international law – the very first form of reparation, replaced by compensation only in case of de-election, impossibility or dis-proportionality. State practice witnesses that such view is shared by many States: If States felt the need to deviate from the aforementioned principle they explicitly included clauses in their treaties stating that restitution is no available form of reparation or restitution is limited to certain situations, or restitution is not the first remedy to be sought by an investor.[125] One can therefore safely conclude that the rules on the form of reparation in the area of investment treaty law, thus, exist in broad systemic integration with general rules as embodied in the ILC Articles on State Responsibility.

Prioritising restitution, it is recalled, is on principle justified by the argument that it

"conforms most closely to the general principle of the law on responsibility according to which the author State is bound to 'wipe out' all the legal and material consequences of its wrongful act by re-establishing the situation that would exist if the wrongful act had not been committed".[126]

121 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, Yearbook of the International Law Commission 2001, vol. II. (Part Two), p. 31, Art. 55, para. 1 - 2.

122 In fact, if Article 33 ASR was to apply and investment treaties were outside the scope of application of the ASR, Article 55 ASR does not play any role anymore.

123 Douglas, The Hybrid Foundations of Investment Treaty Arbitration, 74 BYIL 2004, p. 151, p. 189; *Douglas* appears to operate with some kind of "hybrid" perception of *lex specialis*. It is true that some international treaties which confer rights upon individuals – e.g. the Treaty on European Union ("**TEU**") and the Treaty on the Functioning of the European Union ("**TFEU**") – create a "sub-system" which, although sharing many of the secondary rules contained in the inter-State system, must be analysed independently. However, these treaties contain their own complex sets of secondary rules; investment treaties are usually silent on this point. One must ask the question of whether it is possible to derogate the general rules without having a *lex specialis* in an investment treaty.

124 See also Article 12 (2) ECT, applicable to loss suffered owing to war or other armed conflict, state of national emergency, civil disturbance, or other similar event, which reads *"[…] an Investor of a Contracting Party which, […], suffers a loss in the Area of another Contracting Party […] shall be accorded restitution or compensation which in either case shall be prompt, adequate and effective."* Note also Article 26 (8) 2. sentence ECT which reads *"An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted."*

125 Cf., e.g., Article 1135 (1) NAFTA, Art. 26 (8) ECT; apparently of a different view: Kriebaum, in this volume.

126 Arangio-Ruiz, Preliminary Report on State Responsibility, in: International Law Commission (ed.) Yearbook of the International Law Commission, vol. II (1) 1988; UN Document No. A/CN.4/416 & Corr. 1 & 2 and Add.1 & Corr.1, para. 114.

This paper suggests that in the area of investment treaty law the justification to prioritise restitution is even stronger compared to general public international law. Prioritising restitution contributes to the overall aim of the contracting State parties to the investment treaty to establish and maintain *long term* and *stable* investment relations on the basis of the rule of law and it would further strengthen their "juridification". This is because it would – to some extent – render it less attractive for a host State to employ (internationally) wrongful means to rid itself of a "disliked" foreign investor due to the fact that the possibility of simply "buying oneself out" of the investment relationship by the way of paying compensation would be restricted. Turned positively, prioritising restitution would give the host State a second chance to present itself as being committed to establishing and maintaining long term and stable investment relations on the basis of the rule of law. Already by knowing that it might see the foreign investor "again", the host State has an increased interest in constantly working on the relationship.

Of course, restitution must not be de-elected by the claimant, still be possible and not constitute an excessive onerousness. Material impossibility and excessive onerousness should, however, be assessed in a very strict sense in order to achieve the ends pursued with the conclusion of the investment treaty.

While one could doubt whether such reasoning would be appropriate if an individual were the holder of the substantive rights contained in an investment treaty, if the injured State is perceived as their holder prioritising restitution suits well the State parties' abovementioned "systemic interest" in concluding the investment treaty. Furthermore, from the perspective of the author State the continued cooperation with the foreign investor after having lost arbitration can also be understood as evidence of a matured political and legal system.

D. Summary

"General" international law and investment treaty law do not form two isolated sets of rules. Far from it. This paper demonstrated that Articles 28 *et seqq*. ASR, which set out the content of the international responsibility of a State, can claim validity and are applied in practice in the context of investment treaty law. Since the substantive rights contained in investment treaties accrue to the State parties, the ILC Articles on State Responsibility apply *directly*. The rules on the forms of reparation – including the rule of priority of restitution – contained in the ILC Articles unreservedly govern also the international responsibility caused by the violation of a substantive treatment standard contained in an investment treaty.

This paper further suggested that within investment treaty law the claim to prioritise restitution is a strong one as it contributes to the overall aim of the contracting State parties to the investment treaty to establish and maintain long term and stable investment relations on the basis of the rule of law and it would further strengthen their "juridification". Closing the circle, the choice to be made in investment arbitration between restitution and compensation or between "stay" or "leave", as it was sketched in the introduction, it can be said to contain a slight spin in favour of "staying", a spin which might contribute to the strengthening of a long term perspective on foreign investment relations in investment arbitration.