REPORT ON LALIVE LECTURE OF 29 SEPTEMBER 2022

"A GUIDED TOUR OF THE CHORZÓW FACTORY CASE: A REVIEW OF REPARATION PRINCIPLES IN INTERNATIONAL INVESTMENT LAW"

BY PROFESSOR PIERRE-MARIE DUPUY

This year the LALIVE lecture was given by Professor Pierre-Marie Dupuy, who provided an insightful analysis into the well-known Chorzów Factory judgment, contending that the reparation principles relied on by arbitral tribunals in international investment disputes are often misunderstood. Vincent Reynaud and Maël Deschamps of LALIVE report.

The lecture was held at the Graduate Institute of International and Development Studies in Geneva on 29 September. Michael Schneider, one of LALIVE's founders and senior counsel at the firm, and Professor Zachary Douglas, professor of international law at the Graduate Institute, introduced Dupuy, who is emeritus professor at the Graduate Institute, and counsel as well as arbitrator in numerous inter-state and investor-state cases.

After paying tribute to brothers Pierre and Jean-Flavien Lalive, who he described as close friends and "*great minds*," Dupuy introduced the 13 September 1928 Chorzów Factory judgment of the Permanent Court of International Justice (PCIJ). *Chorzów Factory* is amongst the "*most visited places*" in investor-state arbitration because of the following excerpt:

> "*reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.*"

According to Dupuy, despite being a "*ritual reference*" in investment awards, the precise scope and meaning of this quotation from *Chorzów Factory* is often misunderstood and at odds with the PCIJ's intent.

Dupuy began by recalling that *Chorzów Factory* arose from a claim by Germany that Poland had violated the 1922 Geneva Convention on Upper Silesia. Germany argued that it was pursuing its own rights through the

claim in "*a dispute between governments and nothing but a dispute between governments.*" Poland, on the other hand, argued that Germany was merely defending the rights of the two allegedly injured companies. The PCIJ sided with Germany finding that "*the German application can only be to obtain reparation due for a wrong suffered by Germany in her capacity as a contracting Party to the Geneva Convention.*"

As such, Dupuy explained that the PCIJ firmly established the principle of *restitutio in integrum* as a rule of international law applicable to inter-state relations. The views of Dionisio Anzilotti, then president of the PCIJ and whose writings supported a strict separation between international and municipal law, further support this understanding.

Referring to Philip Jessup, Dupuy argued that international investment law constituted a form of "*transnational law*." As such, a principle of the law applicable between states should not necessarily be transposed to investor-state disputes. Indeed, although BITs and MITs record and sometimes even establish general principles, these rarely provide a definite answer as to the law applicable to disputes between investors and states, be it public international law or municipal law.

He then referred to Article 31(1)(c) VCLT, which provides that "*any relevant rules of international law applicable in the relations between the parties*" be taken into account when interpreting a treaty. He considered this provision to be an invitation to arbitrators to account for states' other substantive obligations such as environmental and human rights ones.

Dupuy also set out to investigate the relationship between customary international law and investor-state arbitration. He criticised investment tribunals' widespread practice of citing Article 35 of the Articles on the Responsibility of States for Internationally Wrongful Acts (ARSIWA) right after mentioning *Chorzów Factory*, as evidence of codification of *restitutio in integrum* in international law. In so doing, tribunals ignore that ARSIWA codify *restitutio in integrum* as a rule of international law applicable to inter-state relations only. Dupuy referred to the late Professor James Crawford, special rapporteur of the ILC, who insisted on this (see *e.g.*, ICSID Review - Foreign Investment Law Journal, Volume 25, Issue 1, Spring 2010, pages 127–199).

This mistaken practice stemmed from a poor understanding of ARSIWA and its structure, he said. Part One of ARSIWA deals with what French law labels *le fait générateur de la responsabilité*, namely what is an internationally wrongful act and how it is attributed to a state. Part Two deals with the legal consequences for the responsible state and Part Three the implementation of international state responsibility (*la mise en œuvre de la responsabilité*). Whereas Part One is applicable in investment arbitration because tribunals must determine whether a state has committed an internationally wrongful act, Parts Two, which includes Article 35, and Three are not. The latter Parts only codify the law applicable to inter-state relations and may only apply to investor-state disputes by analogy.

As such, arbitrators can look to *restitutio in integrum* in public international law for inspiration and possibly go even further by contending that it is a general principle of law recognized by municipal legal systems. Yet they are wrong to apply it as a rule of international law applicable between a state and a private investor. According to Dupuy, arbitrators may therefore apply other sources of law, including municipal law, to reparations.

Dupuy also deplored that, after paying lip service to *Chorzów Factory* and Article 35 ARSIWA, too many arbitrators move straight to the quantification of damages. In so doing, arbitral tribunals tend to rely on the findings of the parties' financial experts, which are often rooted in concepts originating from financial management rather than legal principles used to assess damage.

Taking the example of fair market value, which he underscored was not part of customary international law, Dupuy referred to arbitrators' temptation to rely on quantum experts' but-for scenarios, when seeking to reconstruct the financial situation that existed just before the breach by the host state. In so doing, tribunals assume not only that such a complex exercise of reconstruction can be achieved – a doubtful proposition, especially for early-stage investments – but also take it for granted that a market for the investment in dispute necessarily exists, which is often but not always the case.

Dupuy therefore encouraged arbitrators to systematically conduct a thorough legal analysis and assessment of damage, including foreseeability and remoteness. Taking the example of *préjudice* from French municipal law, Dupuy argued that arbitrators should analyse the components of the damage, assess which part of the damage is legally recoverable, and consider other relevant facts such as the parties' conduct.

Dupuy referred to the works of UNCITRAL Working Group III on investor-state dispute settlement reform as highlighting the necessity of finding a better balance between the legal and financial assessment of damages.

In conclusion, Dupuy insisted that arbitrators in investment disputes should retain control over the entire reasoning underpinning their decisions, including the determination of reparations, which is first and foremost a legal exercise.

The lecture ended with some questions from the audience as well as statements from Douglas and Schneider.

Douglas agreed with Dupuy's analysis. Mentioning discounted cash flow valuations in which quantum experts make myriad assumptions based on financial concepts, Douglas insisted on arbitrators' duty to ensure not only that each assumption be underpinned by existing legal principles, but also that the valuation method be appropriate in the first place.

Schneider remarked that it is of paramount importance for arbitrators to assess the criteria of lost profits, especially if the underlying treaty contains related indicators. He suggested that French administrative law may prove an interesting source from which to draw on, in terms of how a state compensates private individuals.

Further to a question about material restoration, Schneider evoked this as a possible remedy, citing *Texaco v Libya*. Schneider suggested this remedy could encourage parties to settle and prove a cost-efficient solution which avoids enforcement proceedings. Douglas agreed on the principle, but commented that tribunals may be reluctant to award such a remedy because of the difficulty to enforce it.