INTERNATIONALIZATION AND STABILIZATION OF CONTRACTS VERSUS STATE SOVEREIGNTY*

By ESA PAASIVIRTA‡

I. INTRODUCTION

MUCH of the academic discourse on State contracts has focused on the identification of the applicable law. There has been noticeably less effort to elaborate on the substantive aspects of that law. As an example one may refer to the approach adopted by the Institut de Droit International at its Athens session (1977). It is surprising that the Institut considered the question of the applicability of international law, for instance, as the proper law of State contracts, and at the same time excluded any consideration of the substantive consequences following the application of such law.[1]

This approach illustrates the emphasis of doctrinal discussion. A characteristic of the domain of State contracts is that international law has been introduced through the medium of conflict of laws, and the development of substantive law has been left to arbitral tribunals and thus has evolved on a case by case basis. The ICSID Convention[2] is another example of this 'instrumental' trend, for it provides a procedural framework rather than touching upon questions of substantive law. The Convention provides in Article 42(1) that, apart from the law of the host State, a tribunal shall also apply 'such rules of international law as may be applicable'. However, neither the Convention nor the preparatory work gives much guidance on the content of the substantive law.[3] In view of the fact that State contracts constitute a relatively new departure in international law, the above reference to 'applicable' rules may be seen as an indication of the quasi-legislative role which the tribunals play.[4]

‡ Ph. D. (Cantab.); Associate Expert on Legal Aspects of Foreign Trade, International Trade Centre UNCTAD/GATT, Geneva. The views expressed herein are strictly personal and not necessarily shared by the UN or GATT or any of their related agencies.

[1] *Annuaire de l'Institut de Droit International*, 57 (1977), pt. 1, p. 202. The rapporteur, Professor van Hecke, stated merely that the options of international law, and the other non-municipal standards considered by the Institut, are 'utiles à dire': ibid., 58 (1978), pt. 2, p. 62.

[2] Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Washington, 18 March 1965: *UN Treaty Series*, vol. 575, p. 159.

[3] The report of the Executive Directors provides: 'The term "international law" as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice, allowance being made for the fact that Article 38 was designed to apply to inter-State disputes': *ICSID Documents Concerning the Origin and the Formulation of the Convention*, vol. 2, part 2 (1970), p. 1080.

[4] In discussing similar formulations, not infrequently used in international instruments on dispute settlement, Lauterpacht, *The Function of Law in the International Community* (1933), pp. 56–60, draws attention to the distinction between the 'existence' of a rule and its 'applicability'. A rule may exist, but still not be applicable, because it may lead to an unjust result.

Admittedly, it may be practicable to emphasize the 'instrumental' aspects, be they rules of procedure or of conflict of laws, and such an emphasis is probably explicable on the basis of past experience in the area of foreign investments. Several attempts have been made to provide comprehensive, universal, legal standards for investment protection, but they have failed to satisfy the diverse interests involved.[5] Against this background an approach such as the one adopted in the ICSID Convention may thus seem to be a 'stroke of genius' illustrating the 'unavoidable relativity of the distinction between form and substance in the reality of law as in any other sphere of human endeavour'.[6]

In general the above account suggests that in this area, which is so affected by conflicts of interest, arbitral tribunals as well as legal writers play a particularly prominent role in the formation of substantive law.[7] In this article three separate issues will be considered. In order to gain a proper perspective, it is useful first to draw attention to the great diversity of views of various authors on the consequences of the internationalization of State contracts. This will be followed by a discussion of stabilization clauses, and then of matters relating to State sovereignty and permanent sovereignty over natural resources.

II. Assumed Effects of Internationalization

The aim of the present survey is to focus on the various views expressed by different writers. For these purposes a distinction between four different groups can be made.

Group I. The first group consists of those writers who have perceived the effect of internationalization as achieving a more or less absolute protection of the private party to a State contract. The underlying idea has been described as follows:

> The main interest and motive of those who advocate the choice of public international law is the desire to ensure against the possibility of effect being given to a termination or modification of the agreement of the parties by an act of supervening legislation.[8]

Consequently, the internationalization of contracts has been perceived as a

[5] Among such attempts one may mention the Abs-Shawcross Draft Convention (1959) and the OECD Draft Convention (1967). See Schwarzenberger, *Foreign Investments and International Law* (1969), pp. 109–34, 153–69.

[6] Schwarzenberger, ibid., p. 152.

[7] There may not be anything particularly new in this. Historically speaking, the law of State responsibility has to a large extent been elaborated by international tribunals: Brownlie, *System of the Law of Nations: State Responsibility (Part I)* (1983), pp. 1–9.

[8] Suratgar, 'Considerations affecting Choice of Law Clauses in Contracts Between Governments and Foreign Nationals', *Indian Journal of International Law*, 2 (1962), pp. 273, 302.

way to 'deny effect'[9] to unilateral changes by States, the legal justification being the 'unrestricted application of the principle of *pacta sunt servanda*'.[10] Such an effect has been described as a 'detachment'[11] or an 'escape'[12] from the municipal legal systems or a ground to 'ignore'[13] the effects of the legal rules of States. F.A. Mann, one of the earliest contributors, refers to an internationalized contract and states that:

> its existence and fate would be immune from an encroachment by a system of municipal law in exactly the same manner as in the case of a treaty between two international persons.[14]

Hence, the undertakings expressed in the terms of State contracts are 'international obligations' comparable to treaties.[15] Professor Kojanec suggests that it follows from the internationalization that 'the State cannot unilaterally modify the contractual system'.[16] Similarly Professor de Vries has concluded that 'the investors' contract rights cannot be adversely affected by the unilateral action of the host state'. For this reason it is recommended that 'the investor and his counsel should attempt to "internationalize" the contract'.[17] For Professor Garcia-Amador 'the purpose of "internationalization" of a contractual relation must be to "liberate" the relation from municipal law'.[18] He continues:

> As in the case of treaties, when a contract or concession is governed by international law or by international principles, or provides for a mode of settlement of a genuinely international character, the rights of aliens derive from an 'international' source and the obligations of the State are necessarily also international. It follows that the mere non-performance of these obligations directly and immediately gives rise to state responsibility.[19]

[9] Ibid., p. 301.

[10] Ibid., p. 307. For this reason some lawyers have even doubted the applicability of the principle of *rebus sic stantibus* to State contracts. See Ray, 'The Law Governing Contracts Between States and Foreign Nationals', *Proceedings of the Institute of Private Investors Abroad* (1960), pp. 5, 65–9. On the same point another author, discussing the effects of the general principles of law as the proper law of the contract, has stated: 'If this situation exists, then—but only then—there is a case for unilateral alteration or abrogation of a contract': J.-F. Lalive, 'Unilateral Alteration or Abrogation by Either Party to a Contract Between a State and a Foreign National', *Private Investors Abroad* (1965), pp. 265, 278.

[11] Von Mehren and Kourides, 'International Arbitrations Between States and Foreign Private Parties: The Libyan Nationalization Cases', *American Journal of International Law*, 75 (1981), pp. 476, 510–11.

[12] Toriguian, *Legal Aspects of Oil Concessions in the Middle East* (1972), p. 242.

[13] Castberg, 'International Law in Our Time', *Recueil des cours*, 138 (1973-I), pp. 1, 10.

[14] Mann, *Studies in International Law* (1973), pp. 222–3.

[15] Ibid., p. 191. See also Shawcross, 'Problems of Foreign Investment in International Law', *Recueil des cours*, 102 (1961–I), pp. 335, 352–3.

[16] Kojanec, 'The Legal Nature of Agreements Concluded by Private Entities with Foreign States', in Kojanec (ed.), *Les Accords de commerce international, colloque 1968* (1969), pp. 299, 338 (footnote omitted).

[17] De Vries, 'The Enforcement of Economic Development Agreements with Foreign States', *University of Detroit Law Review*, 62 (1984), pp. 1, 20–1.

[18] Garcia-Amador, Fourth Report on State Responsibility, Doc. A/CN. 4/119, *Yearbook of the ILC*, 1959, vol. 2, p. 32, para. 127.

[19] Ibid., p. 33, para. 131.

J.-F. Lalive describes the effects in similar terms:

> Il était difficile d'admettre qu'un Etat pût porter atteinte à des contrats 'internationalisés', librement négociés et acceptés, contrats dont il avait lui-même, par une loi interne, prescrit la forme, dans le libre exercice de sa souveraineté.[20]

In his study in the principle of *pacta sunt servanda* Professor Wehberg concludes that

> the principle is valid exactly in the same manner, whether it is in respect of contracts between states or in respect of contracts between states and private companies.[21]

And Professor Weil states that

> le choix de droit international comme loi du contrat n'a souvent d'autre signification que de rendre applicable à ce dernier certains principes de droit international, notamment *pacta sunt servanda*, de manière à faire regarder l'inéxecution du contrat par l'Etat comme un acte illicite sur le plan international.[22]

The above views suggest a uniform perception of the function of international law as the proper law of a contract. They imply basically that any acts of a State which contravene contractual provisions are unlawful in accordance with the applicable international law. The writers of the next group hold very different views on the matter.

Group II. The second group comprises those writers whose views are practically opposed to the first group. Professor Sereni analyses the suggestion that international law is the proper law of State contracts and rejects it bluntly:

> Each legal system serves the purpose of regulating the status and relations of the social entities for which and among which it exists. An attempt at applying international law to private relations would be tantamount to seeking to apply the matrimonial laws of France or England to relations between cats and dogs.[23]

Wolff states:

> The choice of the law of nations as the proper law of contract includes the choice of all compulsory rules of that legal system, and therefore also the provision that only States can be subject to public international law.[24]

[20] Lalive, 'Contrats entre Etats ou enterprises étatiques et personnes privées. Développements récents', *Recueil des cours*, 181 (1983–III), pp. 9, 110.

[21] Wehberg, 'Pacta Sunt Servanda', *American Journal of International Law*, 53 (1959), pp. 775, 786.

[22] Weil, 'Problèmes relatifs aux contrats passés entre un Etat et un particulier', *Recueil des cours*, 128 (1969–III), pp. 94, 113–14; for similar views, see Böckstiegel, *Der Staat als Vertragspartner ausländischer Privatunternehmen* (1971), p. 308, who suggests such effects with respect to what the author sees as 'quasi-international law agreements'; Cohen-Jonathan, 'L'Arbitrage Texaco-Calasiatic c. gouvernement libyen', *Annuaire français de droit international*, 1977, pp. 452, 474.

[23] Sereni, 'International Economic Institutions and the Municipal Law of States', *Recueil des cours*, 96 (1959–I), pp. 129, 210.

[24] Wolff, 'Some Observations on the Autonomy of Contracting Parties in the Conflict of Laws', *Transactions of the Grotius Society*, 35 (1950), pp. 143, 150–1.

Even if it were possible to apply international law to contractual relations in the above sense, the author continues:

> Indeed a State is able to bind itself towards another State not to exercise its power to legislate insofar as this would lead to a violation of duties which it has established by agreements of an international character. But this does not entail the consequences that a State can by a contract with an individual or with a company limited by shares bind itself to abstain from a full exercise of its right to legislate.[25]

Similar views have also been expressed by others.[26]

The common opinion of this group is that the use of international law, which governs relations between States, as the proper law of contract is inappropriate. Hence, no substantive consequences can reasonably be inferred.

Group III. The third group consists of those who do not reject the applicability of international law to State contracts but do not necessarily adopt the view that it confers absolute protection on the private party. These writers emphasize that the principles of law are not settled.

E. Lauterpacht, in discussing the role and effects of international law within the ICSID system, points out that the application of Art. 42(1) of the Convention is 'somewhat experimental' and 'unpredictable' and that much depends on arbitrators.[27] Similarly, Professor Schwarzenberger doubts whether an ICSID tribunal could apply rules of international law which were laid down in advance. The matter is ultimately left to each individual tribunal; hence, the composition of the tribunal is of importance.[28] Elsewhere, in considering the reluctance of States to opt for international arbitration in investment matters, this author explains: 'Among other reasons, this is due to the growing awareness of the truth that the rule of law means almost inevitably the rule of lawyers.'[29] Since the emergence of the notion of permanent sovereignty over natural resources and the New International Economic Order, Dr Delaume affirms, 'much uncertainty exists as to the precise status of international norms', and he continues:

> Until such time as a consensus of opinion can be achieved in regard to the rules of international law applicable to the relations between foreign investors and host states (and not only developing nations), the effectiveness of 'internationalization' clauses is bound to remain uncertain. The difficulty is not that these clauses cannot

[25] Ibid., p. 151.

[26] 'Das Völkerrecht ist ein Recht für bestimmte Rechtssubjekte und auf diese zugeschnitten. Wendet man es auf die Beziehungen von Privatrechtssubjekten an, so erstreckt man es auf einen ganz anders strukturierten Bereich, für dessen Probleme es nicht geschaffen ist und denen es daher nicht gerecht werden kann': Sumampouw, 'Rechtswahl im Vertragsrecht', *Rabels Zeitchrift für ausländisches und international Privatrecht*, 30 (1966), pp. 334, 347; see also Zweigert, 'Vertrage zwischen staatlichen und nicht-staatlichen Partnern', *Berichte der Deutschen Gesellschaft für Völkerrecht*, 5 (1964), pp. 194, 210–11.

[27] Lauterpacht, 'The World Convention on the Settlement of International Investment Disputes', *Recueil d'études de droit international en hommage à Paul Guggenheim* (1968), pp. 642, 654–5.

[28] Schwarzenberger, op. cit., above (n. 5), at p. 144.

[29] Comment, in Kojanec (ed.), *Les Accords de commerce international, colloque 1968* (1969), at p. 343.

perform the normal function of stipulations of applicable law, but rather that the substantive rules to which they refer are still in a state of flux.[30]

It has been noted moreover that references in State contracts to the principles of international law

were generally construed to protect [investors] against . . . unilateral actions, but these principles are in a state of flux and it is by no means clear that they will continue to afford protection to the private party in the future.[31]

Group IV. Although their views are in some ways similar to those of the previous group, writers of the fourth group put a particular emphasis on international law as a general standard, instead of the narrower interpretation of it as the proper law of contract. These writers typically view the issue of the analogy between contracts and treaties as fallacious and warn of the danger of aprioristic thinking.[32] This approach, with its emphasis on the standards of international law, has been suggested by Judge Jiménez de Aréchaga:

We do not believe that there is an international law of contract, but even if it were so, international law contains the fundamental and overriding principle of the permanent sovereignty of the State over all its wealth and natural resources . . . [I]t is not the contract as such, but the situation as a whole which is governed by international law, whether or not the parties have so stipulated.[33]

Professor Verhoeven emphasizes that the application of treaty rules would be 'parfaitement abusif',[34] and considers it illusory to think that international law contains rules which would prevent a State from terminating or modifying its contract with a private party.[35] Another commentator has suggested recently that:

International law was not intended to regulate mutual contractual relations between States and private entities. However, investors might have an interest in

[30] Delaume, *Transnational Contracts: Applicable Law and Settlement of Disputes. Law and Practice*, Booklet 1 (issued January 1988), pp. 15–16.

[31] Crawford and Johnson, 'Arbitrating with Foreign States and Their Instrumentalities', *International Financial Law Review*, April 1986, pp. 11, 12; another commentator, assessing recent arbitral practice, concludes: 'Staaten haben das Recht ausländisches Viermogen innerhalb ihres Hoheitgebiets zur Förderung des offentlichen Wahls zu nationalisieren. Die Tendenz scheint dahin zu gehen, dass sich die Nationalisierung auch auf "internationalisierte" Verträge erstreckt; der Stand Völkerrechts ist jedoch noch nicht klar': Catranis, 'Probleme der Nationalisierung ausländischer Unternehmen vor internationalen Schiedsgerichten', *Recht der Internationalen Wirtschaft*, 1982, pp. 19, 26.

[32] Lalive, 'Sur une notion du "contrat international" ', *Festschrift Lipstein* (1980), pp. 135, 143, 154. The author emphasizes (p. 154) that the internationalization of a State contract 'ne le rend *a priori* et en soi ni plus ni moins adaptable ou intangible, ni plus ni moins contraignant. Tout dépend du contenu, au moment critique, du droit applicable, quel qu'il soit.'

[33] 'International Law in the Past Third of a Century', *Recueil des cours*, 159 (1978–I), pp. 1, 308 (footnote omitted).

[34] Verhoeven, 'Arbitrage entre Etats et entreprises étrangères: Des règles spécifiques?', *Revue de l'Arbitrage*, 1985, No. 4, pp. 609, 624.

[35] 'Un tel espoir, il n'empêche, est *a priori* parfaitement illusoire. Il n'existe en effet présentement en droit des gens aucune règle qui interdise à un Etat de modifier ou de rompre le contrat qu'il a conclu avec un particulier étranger. Ce n'est point que le droit des gens autorise cette "déstabilisation". C'est simplement qu'il ignore de tels accords qu'il ne régit pas': ibid., p. 623.

there being a reference to international law, in order to ensure the application of standards that are not subject to unilateral amendment by the host country. If a nationalization occurs, for instance, this would become significant with respect to compensation laws which the state otherwise might amend. This does not mean that the parties' legal positions can be protected absolutely in every situation. Such a reference does not necessarily abolish the host country government's power, according to domestic law, to cancel the effect of the contractual clause by promulgating a general legal rule.[36]

It is appropriate at this point to make some comments on the positions of the above four groups. Historically, the first two groups precede the latter two.[37] The common feature between the first two is that both view the role of international law in the narrow sense of *lex contractus* rather than as a general standard. The difference, of course, is that whereas the first group expects the notion of internationalization to provide more or less absolute protection for the private party, the second does not regard it as having any legal effects at all.

The second group considers the use of international law as the applicable law of State contracts to be inappropriate. For these writers the system of international law is purely an inter-State system in which an individual or a company has no legal personality.[38] One should notice, however, that in recent arbitrations no tribunal has felt precluded from applying international law on such a basis, which implies a less State-centred conception of international law. The very existence of the ICSID system suggests the same (i.e. it would appear out-moded completely to exclude contracts from the province of international law). Nevertheless, the views of the second group of writers highlight the innovative way in which international law has been introduced into this domain as the proper law of contracts, and make one aware that the choice of applicable rules is a highly selective process.

It seems that the views of the first group are marginally better reflected in arbitral practice than those of the second group. It suffices for present purposes to note that here too the assumed legal consequences of internationalization of contracts relate to a preconception of the role of international law. The idea of international law as *lex contractus* is thought to provide the most powerful means of giving effect to the individual terms of a contract. As in the case of the treaties between States, the contractual relationship between a State and a foreign company is portrayed in terms of equality. By implication, it follows that the non-performance of contractual undertakings by a State constitutes an unlawful act pursuant to the applicable international law of contract. Ultimately, it seems to be the traditional liberal idea of the freedom of contract which induces the concept of the internationalization of State contracts.

[36] Bartels, *Contractual Adaptation and Conflict Resolution* (1985), p. 110.

[37] See Kuusi, *The Host State and the Transnational Corporation* (1979), p. 99.

[38] Not dissimilar doctrinal views may be traced in the *Aramco* (27 ILR 117) and *Sapphire* (35 ILR 136) awards. For these reasons, at least partly, the Tribunals were led to apply the general principles of law as a standard distinct from international law.

If it is correct to say that the approach of the first group of writers has aprioristic elements, the fourth group tends to be inductively orientated. That is, the rules of international law are investigated generally rather than selectively in order to establish analogies in accordance with preconceived ideas. Undoubtedly such an approach brings an element of uncertainty, which is reflected in the views of the third group of writers.

As the above account suggests, there are several ways in which one may think of the role and effects of international law *vis-à-vis* State contracts. To emphasize this point one may consider the following aggregation of related legal statements. In 1937 the American-Turkish Claims Commission, in referring to international disputes involving private contracts, stated that

> the law of nations does not embrace any 'Law of Contracts', such as is found in the domestic jurisprudence of nations, and such cases are of course not actions on contracts in terms of domestic law.[39]

In 1945 Dr Lipstein wrote that

> international law contains no branch dealing with contracts. If the breach of contract is to form the basis of a claim based on international law, it must constitute a tortious act in the nature of a denial of justice.[40]

Dr S. Friedman, writing in 1953, emphasized that

> contracts cannot be the subject of international disputes since international law contains no rules respecting their form and effect.[41]

The most the International Court of Justice was able to say in 1970 on the institutions of municipal law in general was:

> In this field international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field. This does not necessarily imply drawing any analogy between its own institutions and those of municipal law, nor does it amount to making rules of international law dependent upon categories of municipal law.[42]

Against this background it is surprising to find that in 1977 the Arbitrator in the *Texaco* case, Professor Dupuy, stated *ex cathedra*:

> [C]ontracts between States and private persons can, under certain conditions, come within the ambit of a particular and new branch of international law: the international law of contracts.[43]

Has the law changed? The Arbitrator did not refer to new rules of cus-

[39] *United States of America on behalf of Ina M. Hofmann and Dulcie H. Steinhardt* v. *Republic of Turkey*, Nielsen, *American-Turkish Claims Settlement: Opinions and Report* (1937), pp. 286, 287.

[40] Lipstein, 'The Place of Calvo Clause in International Law', this *Year Book*, 22 (1945), pp. 130, 143.

[41] Friedman, *Expropriation in International Law* (1953), p. 156.

[42] *Barcelona Traction, Light and Power Company Limited* case, Judgment, *ICJ Reports*, 1970, p. 33, para. 38.

[43] 53 ILR at 447–8.

tomary international law. Nor does there exist a general treaty on the matter. If law is perceived statically as a separate objective reality, which has emanated from 'external' sources, it is difficult to reconcile the above statements. It rather seems that the discourse on an 'international law of contracts' is only comprehensible as a legal process involving (competing) values of social morality, economics and politics.

III. Stabilization Clauses—A Special Case?

Generally speaking, the aim of the internationalization of contracts is to stabilize the relationship between a State and a private party. This implies that in case of a dispute the range of applicable legal rules is not restricted to the law of the host State. The latter, which in most cases is the quite natural applicable law of contract, is often seen to pose risks to the private party, as the State may change it in accordance with its sovereign will.[44] Another technique to control the legal powers of a State is to insert so-called 'stabilization clauses' into contracts. The purpose of these clauses, it has been said, is 'to reach a compromise between the sovereign prerogatives of the State involved and the legitimate quest of the private party for stability of status consistent with sound business judgement'.[45] A brief survey of relevant contractual practice may be useful at this point.

A great variety of forms of provision are used. Sometimes a distinction is made between the stabilization clauses proper and the so-called 'intangibility clauses'.[46] An intangibility clause provides that any modification of a contract requires the mutual consent of the parties. A stabilization clause, in turn, aims at 'freezing' the law of a host State and thus preventing a State from using its legislative power to modify the contract in its own favour. An example of an intangibility clause occurs in the 1967 contract between the Ruler of Abu Dhabi and three Japanese companies which provided as follows:

> The mutual consent of the Ruler and the Companies shall be required to annul, or modify, the provisions of this Agreement.[47]

A stabilization clause in the above sense was included in the well-known

[44] As put by Lord Radcliffe, the proper law 'not merely sustains but, because it sustains, may also modify or dissolve the contractual bond': *Kahler* v. *Midland Bank*, [1950] AC 24, 56.

[45] Delaume, *Transnational Contracts: Applicable Law and Settlement of Disputes. Law and Practice*, Booklet 8 (issued July 1983), p. 39.

[46] Weil, 'Les Clauses de stabilisation ou d'intangibilité dans les accords de développement économique', *Mélanges Rousseau* (1974), pp. 301, 307–9.

[47] Art. 33 of the Concession Agreement between the Ruler of Abu Dhabi and Maruzen Oil Co. Ltd., Daikyo Oil Co. Ltd. and Nippon Mining Co. Ltd., 6 December 1967, *Selected Documents of the International Petroleum Industry*, 1967, p. 137; also the Contract between the General Petroleum and Minerals Organization and AGIP Saudi Arabia SpA, 21 December 1967, Art. 21, ibid., p. 190; similar clauses were also included in the Libyan oil concessions which gave rise to the *BP*, *Texaco* and *Liamco* arbitrations, Clause 16 of which provided that the 'contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties'. See respectively 53 ILR at p. 324; ibid. at p. 476; 62 ILR at p. 191.

Concession Agreement of 1933 between Iran and the Anglo-Iranian Oil Company. Article 21 of the Agreement laid down that the

> Concession shall not be annulled by the Government and the terms therein contained shall not be altered either by general or special legislation in the future, or by administrative measures or any other acts whatever of the executive authorities.[48]

It is not unusual to find a combination of these provisions. The Petroleum Agreement of 4 February 1973 between the Sultan of Oman and the Sun Group stipulates in Article 22:

> 22.1 The Sultan shall not annul this Agreement by general or special legislation or by administrative measures or by any other act [except in the event of default by the other party].
> 22.2 The mutual written consent of the Sultan and the Sun Group shall be required to annul, amend or modify the provisions of this Agreement.
> 22.3 The Sultan agrees that no discriminatory laws or decrees affecting the Sun Group or its operations will be enacted.[49]

A stabilization clause of another type may be found in the Concession Agreement between the Government of the Republic of Liberia and the Liberia Iron and Steel Corporation of 2 June 1975. The choice of law provision in Article 21 states:

> This Concession Agreement shall be governed, construed and interpreted in accordance with the laws of the Republic of Liberia excluding, however, any enactment passed or brought into force in the Republic of Liberia before or after the date of this Concession Agreement which is inconsistent with or contrary to the terms hereof.[50]

The above clauses vary in their scope of application. A wide and relatively detailed clause may be found in the 1977 Agreement between Mauritania and a consortium of foreign oil companies, which includes the following provision for a period of 25 years:

> Le gouvernement garantit à la deuzième partie, pour la durée de la convention, la stabilité des conditions générales, juridiques, économiques, financières et fiscales dans lesquelles la deuxième partie exercera son activité, telles que ses conditions

[48] *Anglo-Iranian Oil Co.* case, *ICJ Pleadings*, 1952, p. 86.

[49] Cited in Delaume, op. cit. above (n. 30), Binder 1, Booklet 3.1. (issued April 1986), p. 25; see also the Production Sharing Agreement between the Republic of Togo and Oceanic Resources Ltd., 4 August 1977, Art. 30, ibid.; the Agreement between Kuwait and Kuwait Shell Petroleum Co., 15 January 1961, Art. 27, cited in Delaume, 'Des Stipulations de droit applicable dans les accords de prêt et de développement économique et de leur rôle', *Revue belge de droit international*, 1968, pp. 336, 356; the Joint Venture Agreement between AUXERAP and AQUITAINE, on the one hand, and the Government of Libya and LIPETCO, on the other hand, 30 April 1968, Art. 40 (III), *Selected Documents of the International Petroleum Industry*, 1968, p. 197; the Petroleum Concession Agreement between the Ruler of Abu Dhabi and Phillips Petroleum Co., American Independent Oil Co. and AGIP SpA, 21 January 1967, Art. 24, ibid., 1967, p. 165; a similar clause was the subject of careful consideration in the *Aminoil* award in 1982: 66 ILR 546.

[50] Fischer (ed.), *A Collection of International Concessions and Related Instruments* (hereinafter *CICRI*), vol. 1, p. 113; see also Jordan-Yugoslav Oil Concession Agreement, 8 March 1968, Art. 30, *Selected Documents of the International Petroleum Industry*, 1968, p. 335.

résultent de la législation et de la réglementation en vigueur à la date de signature de la convention ainsi que des dispositions de ladite convention.[51]

Such provisions are often addressed to defined areas, such as taxation,[52] corporate status or mining legislation.[53]

From the viewpoint of host States, the clauses discussed here are a means of attracting foreign investment. They are a part of the bargaining process as a whole. It is probably for these reasons, which involve a balancing of opposing interests, that some clauses seem ambiguous and cause difficulties of interpretation. This is the case, for instance, when the law of a State Party is at the same time chosen as the applicable law of the contract, as in the above cited Liberian contract of 1975. Another example is the Sales and Purchase Agreement of 1973 between Iran and a consortium of oil companies. It provided:

> This Agreement shall be interpreted in accordance with the laws of Iran. The rights and obligations of the Parties shall be governed by and according to the provisions of this Agreement. The termination before expiry date or any alteration of this Agreement shall be subject to the mutual agreement of the Parties.[54]

In a dispute involving the question of a subsequent legislative change, the relevance of the clause depends on whether the 'interpretation' in the first sentence is given a clearly different meaning from the 'rights and obligations', which are said to be 'governed' by the agreement. This would then imply that in a certain situation matters considered as interpretation are resolved by the law of the host State, whereas with regard to some other matters the question of the applicable law is left open. Such a view has

[51] Convention of Establishment Between the Islamic Republic of Mauritania and AGIP SpA, Getty Oil International (Mauritania) Inc., Hispánica de Petróleos SA (Hispanoil) and Phillips Petroleum International Corporation Mauritania Inc., 29 April 1977, Art. 4, *CICRI*, vol. 6, p. 279.

[52] For a detailed formulation of a tax clause, see the Foreign Investment Agreement between the Republic of Chile and the Foote Mineral Company of Pennsylvania, 25 March 1977, Clause 7 (9), *CICRI*, vol. 6, p. 27. A tax clause, but with a further extension of stabilizing the 'juridical terms of the present Convention', may also be found in the Investment Agreement between the Republic of Burundi and the Roumanian State enterprise GEOMIN, 16 May 1977, Art. 5(4), ibid., p. 329. Furthermore, tax clauses may be graded in the sense that the extent of stabilization is greater during the start-up period than during the time of commercial operation. This is the case in the Brazilian Model Service Contract for Onshore and Offshore Operations between Petróleos Brasileiros SA (PETROBRAS) and Private Contractors (1979), Art. 21(3): see Delaume, op. cit. above (n. 45), Binder 1, Booklet 3. (issued April 1986), p. 42. A clause freezing the relevant tax laws was the central issue in the *Revere* arbitration (1978), 56 ILR 258.

[53] For a clause concerning the corporate status, see *AGIP* award, *International Legal Materials*, 21 (1982), p. 727. A provision relating to mining legislation is included in the Concession Contract between the Government of Ecuador and Texas Petroleum Company, 21 February 1964, Art. 41, which states: 'The concessionary bind themselves especially to the Oil and Mining Laws, the provisions of which, as they are in force at the time of signature of this contract, are understood to be incorporated in the same and shall rule the relations between the parties in every aspect that had not been expressly agreed upon by them': Delaume, loc. cit. above (n. 49), at p. 358 (n. 59).

[54] Art. 29; Art. 28 contained a clause referring to international arbitration: *Selected Documents of the International Petroleum Industry*, 1973, p. 42.

recently been confirmed by the Iran-United States Claims Tribunal in the *Consortium* case.[55]

This might be the case in the following example of a Venezuelan oil contract which provided:

> This instrument cannot be modified in any way except in writing signed by the parties. This Agreement shall be governed by the laws of the Republic of Venezuela.[56]

An oil contract concluded in 1976 by the Government of Qatar also suggests a delicate balancing of interests. Article 33 reads:

> Without prejudice to the Government's prerogative of sovereign powers the mutual consent of the Parties hereto shall be required to annul, amend or modify the provisions of this Agreement.[57]

The last-mentioned contracts have two distinctive features. On the one hand, they refer to the law of the host State as the applicable law. On the other hand, the contracts include stabilization provisions and refer to international arbitration for dispute settlement. Thus, there are different interests involved, which different contract provisions aim to protect. It could be suggested that in fundamental matters, such as those concerning the very existence of a contract, the applicable law is in fact left to the arbitral tribunals to determine. Otherwise, stabilization provisions might remain completely meaningless (if their legal effect is assessed in accordance with the law of the State Party, subsequently amended), or one would be faced with the much criticized idea of a 'contract without law'.[58]

The legal effect of stabilization clauses may be viewed in two ways. First, the clauses may be dealt with in terms of substantive law. Secondly, one may approach them from the viewpoint of the conflict of laws. The latter approach will be considered first.

The present trend concerning international commercial arbitration allows much freedom in the choice of applicable conflict of laws rules. Arbitrators are not necessarily bound to apply any single national system of private international law. If a stabilization clause is perceived as a kind of

[55] *Iran–US Claims Tribunal Reports*, vol. 16, at p. 27.

[56] Agreement for the Purchase and Sale of Crude Oil and Petroleum Products between Petróleos de Venezuela and Exxon International Limited, 1 January 1976, Art. 15 (1), *CICRI*, vol. 2, p. 317. Art. 16 (1) contains an ICC arbitration clause.

[57] Exploration and Production Sharing Agreement between the Government of Qatar and Holcar Oil Co., 1 January 1976, Art. 33, ibid., p. 249. Art. 34 contains an arbitration clause providing that the place of arbitration is left at the discretion of the arbitrators. Art. 28 (B) states moreover that the applicable law is the law of Qatar.

[58] In a case where there is no arbitration clause and the disputes are settled by the courts of a host State, there is hardly any way to give effect to such clauses. This is due to the fact that State courts operate within clearly defined constitutional constraints so that in most cases it is unthinkable that they could stand against the will of a legislator in pursuance of its public interest. See also below, n. 74, and the accompanying text.

'negative' choice of law clause, providing that certain laws should *not* be applied, this leads to the question of whether the principle of autonomy of will should apply in a less forceful way than it does in the case of a 'positive' choice of law. If the matter is then addressed directly to an arbitral tribunal, as has been suggested,[59] it is difficult to ignore such provisions.

As an example of an arbitral framework which would allow this kind of thinking, one may take the UNCITRAL Model Law on International Commercial Arbitration of 25 June 1985. Article 28(1) provides:

> The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute.[60]

The relevant report stated that, according to one view, the expression 'rules of law' was 'novel and imprecise'. On the other hand, the formula was seen to provide a necessary 'flexibility' as it allowed the parties to subject their relationship to the most suitable rules for their situation.[61] Even the other viewpoint, which had preferred the expression 'law', thought that a *dépeçage* of applicable law should be allowed.[62]

By treating stabilization clauses as negative choice of law clauses, complex questions of substance are avoided, in particular the issue of the binding force of contracts and how it relates to State sovereignty. While the above discussion suggests that a total rejection of the validity of stabilization clauses is difficult to maintain, an approach on the basis of conflict of laws alone is too narrow. It should go without saying that, even if the validity of stabilization clauses may be recognized as a negative choice of law, one ought not to draw conclusions which are too far-reaching from this.[63] Should one reject, *arguendo*, the effect of such clauses, wholly or partially, as a matter of substantive international law, this would restrict the use of conflict of laws techniques as well.

Expropriatory measures of the host State, affecting the performance of a contract on the State territory, are normally mandatory rules of that State. They cannot be ignored simply because they remain outside the proper law of the contract. Instead, such legal rules need to be taken into consideration, and applied selectively, within the confines of public international

[59] Tschanz, 'Contrats d'État et mesures unilatérales de l'État devant l'arbitre international', *Revue générale de droit international public*, 74 (1985), pp. 47, 57.

[60] Reproduced in *International Legal Materials*, 24 (1985), p. 1302.

[61] UNCITRAL Report Excerpts, ibid., pp. 1314, 1350–1.

[62] Ibid., p. 1351. For similar remarks with respect to the expression 'rules of law' in Art. 42 (1) in the ICSID Convention, see Delaume, 'La Convention pour le règlement des différends relatifs aux investissements entre Etats et ressortissants d'autres Etats', *Clunet*, 93 (1966), pp. 26, 48.

[63] It should be emphasized that the Institut de Droit International, which discussed the question of applicable law of State contracts at its Athens session (1979), abandoned, by a majority vote, the original draft article which referred to stabilization clauses. As the general perspective of the Institut was one of private international law, it was apparently felt that such a reference would have necessarily involved issues of substantive law, which had been left beyond the investigation. See *Annuaire de l'Institut de Droit International*, 58 (1959), pt. 2, pp. 92–6.

law, as 'directly' or 'immediately' applicable rules.[64] Assuming then that an enactment of an expropriatory decree regardless of a stabilization clause is considered as a part of the sovereign rights of the State, and thus an internationally lawful act *per se*, such a decree should be applied by an arbitrator as far as its effect of terminating the contract is concerned, though not necessarily to the extent that it deprives the private party of compensation.[65]

The last remarks lead to the question of the content of substantive international law on the matter. Three main positions may be distinguished.

First, there is the view that because of a specific contractual commitment to the contrary, a unilateral termination of a contract constitutes an internationally unlawful act. Under this view, the existence of a stabilization clause renders a contract different in kind and may result in the categorizing of a breach as unlawful, which it would not have been in the absence of such a clause. This was the view of the United Kingdom in the *Anglo-Iranian Oil Company* case, where it was submitted:

> The Government of the United Kingdom does not dissent from the proposition that a State is entitled to nationalize and, generally, to expropriate concessions granted to foreigners to the same extent as other property owned by foreigners. The exercise of that right, with regard to concessions and other property rights, is, however, subject to limitations clearly established by international practice and resting on well-recognized principles of international law. These limitations include, in particular, the principle that a State is not entitled to nationalize a concession if, by . . . a provision in the contract of concession it has expressly divested itself of the right to do so . . .[66]

[64] For support one may refer to the Draft Recommendations on the Law Applicable to International Contracts of 1980 by the Commission on Law and Commercial Practices of the International Chamber of Commerce. Art. 9 provides alternatively:

'Alternative 1.

Even when the arbitrator does not apply the law of a certain country as the law of governing the contract he may nevertheless give effect to mandatory rules of the law of that country if the contract or the parties have a close contact to that country and if and insofar as under its law those rules must be applied whatever be the law applicable to the contract. On considering whether to give effect to those mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

Alternative 2.

Even when the arbitrator does not apply the law of a certain country as the law applicable to the contract he may nevertheless give effect to the mandatory rules of the law of that country if the contract or the parties have a close contact to the country in question especially when the arbitral award is likely to be enforced there, and if and insofar as under the law of that country those rules must be applied whatever be the law applicable to the contract':

reproduced in Lando, 'Conflict of Law Rules for Arbitrators', *Festschrift Zweigert* (1981), pp. 157, 176; a similar provision to the first alternative is adopted in Art. 7 (1) of the European Convention on the Law Applicable to Contractual Obligations, 1980; for arbitral practice, see Derains, 'Les Normes d'application immédiate dans la jurisprudence arbitrale internationale', *Mélanges Goldman* (1982), pp. 29, 38–40; see also the discussion in the *BP* award, 53 ILR 296.

[65] A not dissimilar approach is reflected also in Mayer, 'Mandatory Rules of Law in International Arbitration', *Arbitration International*, 2 (1988), pp. 274, 285, 292–3.

[66] *ICJ Pleadings*, 1952, p. 85. It was also claimed: 'In the case of a concession containing no clause in which the grantor State has expressly divested itself of the right of unilateral termination, there may even be an *implied* term that the concession may be terminated by lawful nationalization. In the other

Similar views are reflected among writers.[67] Most writers employ subjective arguments (i.e. referring to the will of the parties or the State's capacity to bind itself) suggesting that if a State can restrict the use of its prerogatives through a treaty, it can do so also through a contract.[68] This is sometimes combined with an objective argument, which emphasizes the legitimate expectations of the parties and principles such as good faith and estoppel.[69] Consequently, the stabilization clauses are seen to provide as it were a 'protection accrue, protection au second degré'.[70]

These views have been met with scepticism by others.[71] If the line of argument of the previous group was predominantly subjective, the second group typically resorts to objective arguments. A critic need only emphasize that State contracts are not treaties, because of the involvement of a private party.[72] Alternatively, it could be argued that there is no international customary rule which would make stabilization clauses a special case for the assessment of the legality of unilateral termination of a contract.[73] These views can also be criticized on the basis of the 'general principles of law', which are a source of law under Article 38(1)(*c*) of the Statute of the International Court of Justice. Instead of the loose rhetoric of *pacta sunt servanda*, which is prevalent, stricter considerations such as the constitutional principles of most legal systems tend to cast doubt on the ability of States to fetter their future legislative freedom by contracts.[74]

case, however, such as the present one, where there is an express term that the concession shall not be so terminated, there is clearly no room for the implied term as stated above: *expressum facit cessare tacitum*': ibid., p. 89.

[67] See Fischer, *Die Internationale Konzession* (1974), p. 410; Greenwood, 'State Contracts in International Law—The Libyan Oil Arbitrations', this *Year Book*, 53 (1982), pp. 27, 63; van Hecke, 'Contracts Between States and Foreign Private Persons', in Bernhardt (ed.), *Encyclopedia of Public International Law*, vol. 7, pp. 54, 56; Weil, loc. cit. above (n. 46), pp. 327–8; also White, *Nationalization of Foreign Property* (1961), p. 178 (though emphasizing time-limits in this respect).

[68] Weil, loc. cit. above (n. 22), at p. 233.

[69] Lalive, loc cit. above (n. 20), at pp. 59–60; also Weil, loc. cit. above (n. 46), at pp. 324–6.

[70] Lalive, loc. cit. above (n. 20), at p. 60; for a further discussion on the 'subjective' and 'objective'; ways of argument, see below, Section IV (b).

[71] Delaume, op. cit. above (n. 45), Booklet 8, p. 39; Goldman, 'Le Droit applicable selon la Convention de la B.I.R.D., du 18 mars 1965, pour le règlement des différends relatifs aux investissements entre Etats et ressortissants d'autre Etats', *Investissements étrangers et arbitrage entre Etats et personnes privées* (1969), pp. 133, 153.

[72] Delson, *The International Law Association, Report of the Forty-Eighth Conference, New York, 1958*, at p. 156; Friedmann, *Law in a Changing Society* (1959), p. 457.

[73] In the *Anglo-Iranian Oil Co.* case the British Government suggested the reverse. As an attempt to 'objectivize' the argument, it was claimed that the restriction of the exercise of sovereignty by contractual clauses was 'clearly established by international practice' and rested on 'well-recognized principles of international law'. See above, n. 66 and the accompanying text. Such a view is not, however, usually shared by writers. Mann, op. cit. above (n. 14), at p. 322, concludes: 'The Truth is that even in international law the express exemption from the effects of future legislation is redundant'; Foilloux, *La Nationalisation et le droit international public* (1962), pp. 302–3, emphasizes that the whole matter of distinguishing the stabilization clauses as a special case poses 'un faux problème'.

[74] 'It will have become clear to oil companies that the UK and Norwegian Governments are no more willing than their OPEC counterparts to stick rigidly to contracts that they deem unreasonably disadvantageous and that there is no absolute constitutional protection in either country for the principle of *pacta sunt servanda*': Daintith and Gault, 'Pacta Sunt Servanda and the Licensing and Taxation of North Sea Oil Production', *Cambrian Law Review*, 8 (1977), pp. 27, 42. For other such comparative

Moreover, stabilization clauses may be regarded as a derogation from the principle of State sovereignty in international law.[75]

In addition to the opposing viewpoints outlined above, a third position has emerged more recently. While it has the same origin as the second view, i.e. that stabilization clauses cannot make the legal situation different in kind as far as the question of international legality of unilateral termination is concerned, there is common ground with the first-mentioned view as well. On this new approach, stabilization clauses are not rendered meaningless, but are taken into consideration in the context of determining the amount of compensation. They gain a financial function. Judge Jiménez de Aréchaga, while rejecting the view that such provisions could deprive the State of legal power to terminate a concession, writes:

> This does not mean that such stabilization clauses have no legal effect and may be considered as unwritten. An anticipated cancellation in violation of a contractual stipulation of such a nature would give rise to a special right to compensation; the amount of the indemnity would have to be much higher than in normal cases since the existence of such a clause constitutes a most pertinent circumstance which must be taken into account in determining the appropriate compensation. For instance, there would be a duty to compensate also for the prospective gains (*lucrum cessans*) to be obtained by a private party during the period that the concession still has to run.[76]

Whether stabilization clauses imply that lost future profits would always be recoverable, at least to their full extent, is uncertain, for, to date, the arbitral awards are unclear on this point. It suffices to say that this third position has certain advantages. On the one hand, it is easy to reconcile with the traditional view of the law of State responsibility, which does not consider contract breaches internationally unlawful *per se*. On the other hand, it gives effect to contractual practice. As stabilization clauses are a means of attracting foreign investors, they have an important market function. An outright rejection of all legal effects for such clauses may have undesirable policy implications, as such

studies, see Baloro, 'The Legal Status of Concession Agreement in International Law', *Comparative and International Law Journal of South Africa*, 19 (1986), pp. 410, 410–18; Flint, 'Foreign Investment and the New International Economic Order', in Chowdhury (ed.), *Permanent Sovereignty Over Natural Resources in International Law* (1984), pp. 144, 161–3; Wengler, 'Nouveaux aspects de la problématique des contrats entre Etats et personnes privées', *Revue belge de droit international*, 1978–9, pp. 415 ff. The problem is also displayed in the different emphases on this particular point between the *Texaco* and *Revere* cases. In the latter the Tribunal gave some effect to the constitutional principle that the State cannot fetter its future legislative freedom by a contract: 56 ILR at p. 281, 286. In the *Texaco* award, in turn, the only principles of Libyan law which were referred to were taken from the Civil Code ('The contract makes the law of the parties') or selectively chosen from the traditional Islamic law ('Muslims are bound by their contracts'): 53 ILR at pp. 472–3.

[75] Sornarajah, *The Pursuit of Nationalized Property* (1986), p. 93; in their comment on section 712 of the American Law Institute's *Restatement of the Foreign Relations Law of the United States* the reporters observed on stabilization clauses: 'Inclusion of such clauses may be resisted by some states, however, on the ground that they constitute a derogation from the state's sovereignty': *Restatement of the Law (Third)*, p. 215.

[76] Loc. cit. above (n. 33), at p. 307; see also Schachter, 'International Law in Theory and Practice', *Recueil des cours*, 178 (1982–V), pp. 9, 313–14; Geiger,'Unilateral Change of Economic Development Agreements', *International and Comparative Law Quarterly*, 23 (1974), pp. 73, 99, 103.

investment could be unduly discouraged. Not dissimilar considerations, though expressed with caution and reservation, are reflected in the Secretary-General of the United Nations' report of 7 May 1981 on permanent sovereignty over natural resources:

> A recurrent provision, even in very recent contracts, is the freezing of the tax regime applicable at the time of the negotiation. Some of the freezing clauses negotiated at present tie the hands of the Government for a very long period. Long and comprehensive 'freezing' clauses seem to run counter to the principle of permanent sovereignty over natural resources, although it may be conceivable that provisions to stabilize the fiscal regime for a reasonable period, so as to assure loan repayment, for example, can be found acceptable under specific conditions.[77]

An overview of contractual practice on stabilization clauses has been given above and, moreover, certain aspects relating to their legal effects have been considered. While stabilization clauses may not be a unique exception to the otherwise lawful termination of contracts, it would seem difficult to deprive them of all legal effect. In this respect, what has been considered above as the third position, put forward by Judge Jiménez de Aréchaga in particular, seems the most attractive. It is also in keeping with most arbitral practice. However, before this conclusion is too firmly adopted, the question of State sovereignty must be discussed.

IV. Sovereignty

(a) *Sovereignty and Property*

The original meaning of sovereignty is related to the idea of superiority. Etymologically, it stems from the Latin word '*supra*'. In legal and political theory the sovereign is the holder of ultimate power. In the modern world it is the State.[78]

In international law the most common meaning ascribed to sovereignty is the idea of independence. The classic definition given by Judge Huber in the *Island of Palmas* case (*Netherlands* v. *USA*) provides:

> Sovereignty in the relations between States signifies independence. Independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other State, the functions of a State.[79]

[77] E/C. 7/119, p. 24, para. 68. With regard to recent contractual practice relating to coal mining (in countries such as China, Colombia, Indonesia, Botswana and Tanzania) the Secretary-General's report of 7 April 1983 observes: 'In many of these contracts, Governments have delegated management to the mining companies. Fiscal regimes are comparatively favourable to companies and are generally protected by stabilization guarantees': E/C. 7/1983/5, p. 7.

[78] In general, see Wildhaber, 'Sovereignty and International Law', in Macdonald and Johnston (eds.), *The Structure and Process of International Law* (1983), pp. 425, 425–31.

[79] Permanent Court of Arbitration, 4 April 1928, *UN Reports of International Arbitral Awards*, vol. 2, pp. 829, 838. See also the individual opinion of Judge Anzilotti in the *Austro-German Customs Union* case, *PCIJ*, Series A/B, No. 41, p. 57 (advisory opinion of 5 September 1931).

Modern writers often emphasize that sovereignty is a relative notion.[80] From this perspective, it is 'sovereignty within law', giving effect to the idea of the rule of law in international society.[81] Indeed, a growing body of international regulation places restrictions of varying degrees on State behaviour in general. Not only is this true in the traditional relations between States ('external' sovereignty), but also within States ('internal' sovereignty). There is, moreover, the whole area of human rights, which sets standards for the treatment of individuals, aliens and nationals alike. Therefore, instead of emphasizing such ideas as independence or freedom, it is more realistic in view of the stage to which international law has evolved to perceive sovereignty as a legal power, or a bundle of powers regulated by law.[82] Hence, sovereignty is not an isolated 'thing', but a relational concept, a power among other powers.

Property, too, is often seen as providing a set of powers *vis-à-vis* other people (or States).[83] As such, it is a part of the same international legal structure as sovereignty. The relationship between the two sets of powers (i.e. sovereignty and property) has been a matter of continuous controversy in international law. The doctrinal debate has probably most often concerned the right of States to nationalize or expropriate foreign-owned property. In principle, such a right of action is recognized as a part of the legal powers inherent in statehood. However, these powers have not remained unfettered. Traditionally, it has been required that, in order to be lawful, a nationalization or expropriation has to be undertaken in the public interest, without discrimination, and with payment of compensation.[84] This implies that international law recognizes what is usually known as 'the social function of property'. Accordingly, property is not conceived purely as a des-

[80] Wildhaber, loc. cit. above (n. 78), at p. 473 and the authorities referred to therein.

[81] Larson, Jenks and others, *Sovereignty Within the Law* (1965), pp. 10–19.

[82] For an inspiring analysis, see Allott, 'Power Sharing in the Law of the Sea', *American Journal of International Law*, 77 (1983), pp. 1, 10–11, 26–7; cf. Kelsen, *General Theory of Law and State* (1949), pp. 348–9, who perceives national law as a 'delegation' by international law.

[83] Allott, loc. cit. (previous note), at p. 9.

[84] See, for instance, O'Connell, *International Law* (2nd edn., 1970), vol. 2, pp. 776–7; White, op. cit. above (n. 67), pp. 119–50, 183 ff. While the requirement of 'public interest' or 'public purpose' is often enumerated as one of the conditions for the lawfulness of expropriatory action, its practical relevance may turn out to be rather insignificant. In other words, in a system of sovereign States, the definition of 'public interest' in substantive terms tends to be elusive. Hence, it is the corporate definition which often subsists: public interest is what a State claims it to be. So, in the *Liamco* award, it was stated that '[m]otives are indifferent to international law, each State being free to judge for itself what it considers useful or necessary for the public good . . .': 62 ILR at p. 194. Alternatively, it may appear easier to argue in negative terms as the matter was put by the claimant in the *BP* arbitration: 'Whether the [Libyan] actions are characterised as not being for a public purpose, or as arbitrary or as abusive, is largely a question of terminology since the authorities often use them inter-changeably': *Memorial of the BP Exploration Company (Libya)*, part 2, 8 August 1972, p. 37, para. 140. Apart from discrimination, the absence of public purpose has only exceptionally constituted the reason for holding an expropriation to be unlawful. This was, however, confirmed in the *Walter Fletcher Smith* claim (*US* v. *Cuba*), Award of 2 May 1929 (C. Hale), *UN Reports of International Arbitral Awards*, vol. 2, pp. 913, 917. See also the *Letco* award, below, p. 346. Owing to the difficulties mentioned above, it has been suggested that expropriation should not be ruled unlawful solely on the ground of lack of a public purpose: White, op. cit. above (n. 67), at p. 150.

cription of a legal relationship between an owner and a thing, but rather within a wider societal context.[85] For this reason the notion of property is said to involve a 'tripartite' relationship: an owner, an object and a society.[86] This view is expressed in the UN Resolution 1803 (XVII) of 14 December 1962, which provides *inter alia*:

> 4. Nationalization, expropriation, or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law.[87]

The idea of the social function of property not only relates to the immediate power relationship (lawful/unlawful acts *per se*), but most often its practical relevance bears on the standards of compensation. As Professor Brownlie suggests: 'It is all very well to say that nationalization is possible—providing prompt and adequate compensation is paid. In reality this renders any major economic or social programme impossible . . .'[88] Or, as Professor Rosalyn Higgins points out, in deciding on compensation one is really deciding where the loss shall lie. Is it to be borne by the individuals or by society?[89] As the question of compensation merits discussion beyond the scope of this article, it suffices to say that prima facie, the notion of 'appropriate' compensation goes further than 'full' compensation in giving effect to the idea of the social function of property.

Having described the relationship between sovereignty and poverty in general, it is necessary to consider whether it applies to contractual relationships.

(b) *The Exercise of Sovereignty and State Contracts—Polarity of Arguments*

In the earlier discussion on the effects of internationalization of contracts and stabilization clauses, the different forms of argument were mentioned. Ultimately, the notions of 'subjective' and 'objective' arguments address themselves to the question of State sovereignty and therefore some elaboration is required here.[90]

[85] Katzarov, *Théorie de la nationalisation* (1960), pp. 172–3; see also Seidl-Hohenveldern, 'The Social Function of Property and Property Protection in Present-Day International Law', in Karlshoven, Kuyper and Lammers (eds.), *Essays on the Development of the International Legal Order* (1980), pp. 77, 79.

[86] Kronfol, *Protection of Foreign Investment* (1972), p. 20.

[87] Reproduced in *International Legal Materials*, 2 (1963), p. 223.

[88] *Principles of Public International Law* (3rd edn., 1979), p. 537.

[89] 'The Taking of Property by the State: Recent Developments in International Law', *Recueil des cours*, 176 (1982–III), pp. 259, 277.

[90] For a comprehensive analysis of the game 'international legal argument', see Koskenniemi, 'Sovereignty: Prolegomena to a Study of the Structure of International Law as Discourse', *Juris Gentium*, vol. 4, nos. 1–2, pp. 71 ff.; id., *From Apology to Utopia: The Structure of International Legal Argument* (1989).

Sovereignty, in objectivist terms, is a principle of international law which provides for certain rights and powers.[91] Contracts, in turn, may be conceived as a type of property. This implies that, as far as the fundamental legal powers between the contracting parties are concerned, the same basic principles should apply as those which concern the international status of foreign-owned property in general. The core power relationship remains the same. In the context of expropriation, involving unilateral termination of contracts, this would imply that such action is lawful, provided that the above-mentioned general conditions (the requirement of public interest, non-discrimination, payment of compensation) are satisfied. This view is explicitly stated in the *Liamco* award and implied in a good number of other cases.

Instead of pursuing these ideas further, the focus will be on the subjective arguments—or, on the 'exercise' of sovereignty, as the conclusion of State contracts is often characterized. Some examples will be given below.

In the *Anglo-Iranian Oil Co.* case the following submission was made by the United Kingdom:

> The right of expropriation for the purpose of nationalization or otherwise is admittedly an important right of sovereignty. Yet it does not follow that a State *cannot* for a defined period part with the *exercise* of that right in respect of any specific property or category of property or in relation to any class of persons. Thus, there is no doubt that State A *may* in a treaty concluded with State B bind itself not to nationalize in any circumstances . . . To give another example, the right to regulate immigration and the right to impose tariffs are important prerogatives of sovereignty. But a State *may* validly and with binding effect agree to a limitation or renunciation of these rights. The Government of the United Kingdom contends that with regard to nationalization or any other legislative measure affecting the property of foreigners, it is irrelevant that the limitation of the legislative freedom of the State—such as is most clearly expressed in Article 21 of the 1933 Concession Convention—is provided not in a treaty proper but in a contract with a foreign national.[92]

The *Aramco* Tribunal declared:

> By reason of its very sovereignty within its territorial domain, the State possesses the legal *power* to grant rights which it forbids itself to withdraw before the end of the Concession, with the reservation of the Clauses of the Concession Agreement relating to its revocation. Nothing *can* prevent a State, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the concessionaire irretractable rights. Such rights have the character of acquired rights.[93]

[91] For a further discussion of the usage of sovereignty as a 'principle' of law, see id., 'General Principles: Reflections on Constructivist Thinking in International Law', *Oikeustiede-Jurisprudentia* (1985), pp. 117, 126–7, 142 ff.

[92] *ICJ Pleadings*, 1952, at p. 90 (emphasis added, footnotes omitted).

[93] 27 ILR at p. 168 (emphasis added).

Similar views are also expressed in *RCA* v. *China*. The Tribunal stated:

> The Chinese Government *can* certainly sign away a part of its liberty of action, and this is also in the field of the establishment of international radio-telegraphic communications and of its cooperation therein. It *can* do so as well in an implicit manner, if a reasonable construction of its undertakings leads up to that conclusion.[94]

This line of argument appears most clearly in the *Texaco* award. In dealing with the notion of sovereignty, the Arbitrator first emphasized that the right to nationalize as such is unchallengeable as a rule of customary international law.[95] Nonetheless this was followed by an assertion for which no authority was cited, that 'the case is totally different where the State has concluded with a foreign contracting party an internationalized agreement'.[96] The Arbitrator went on to say that '[t]here is no doubt that in the exercise of its sovereignty, a State has the *power* to make international commitments'.[97] Regarding Libyan law, which was applicable as well as international law, it was held that 'the Libyan State *can* validly contract with subjects of foreign law'.[98] The public authority, the Tribunal added, 'is also *empowered* to enter into contracts . . .'. Moreover, '[t]here is no need to dwell at any great length on the existence and value of the principle under which a State *may*, within the framework of its sovereignty, undertake international commitments with respect to a private party. This rule results from the discretionary *competence* of the State in this area . . .'[99] In addition, treaties were invoked as an argument by analogy. Hence, the point was made that '[t]he right . . . *to undertake* commitments . . . with another State is unquestionable'. The Tribunal referred to the *Wimbledon* case, reiterating the view that 'sovereignty is not negated by the conclusion of a treaty but, quite the contrary, . . . the conclusion of a treaty is a *manifestation* of such sovereignty'.[100] While it was not suggested that a State contract should be equated with a treaty, the view expressed in the *Wimbledon* case had 'logically the same scope and significance' with respect to contracts.[101] The Tribunal concluded:

> The result is that a State cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and cannot through

[94] *UN Reports of International Arbitral Awards*, vol. 3, at p. 1627 (emphasis added).
[95] 53 ILR at p. 469.
[96] Ibid., 470–1.
[97] Ibid., 471 (emphasis added).
[98] Ibid., 472 (emphasis added). In support of this, the Tribunal referred to the Koran ('Muslims are bound by their contracts') and Art. 147 (1) of the Civil Code ('The contract makes the law of the parties'): ibid.
[99] Ibid., 473 (emphasis added).
[100] Ibid. (emphasis added); for the *Wimbledon* case (*France, Great Britain, Italy and Japan* v. *Germany*), judgment of 17 August 1923, see *PCIJ*, Series A, No. 1 (1923) p. 25; similar formulation is also used in the *Exchange of Greek and Turkish Populations* (advisory opinion, 21 February 1925), *PCIJ*, Series B, No. 10 (1925), p. 21.
[101] 53 ILR 389, 473.

measures belonging to its internal order make null and void the rights of the contracting party which has performed its various obligations under the contract.[102]

The pattern of thought expressed in the *Texaco* award is closely followed in the *AGIP* case, decided by an ICSID Tribunal. Likewise, it was emphasized that State practice undoubtedly gives confirmation to the right of nationalization. In spite of this, the Tribunal continued, positive international law also recognizes that by concluding an international agreement with a private individual 'the State *exercises* sovereign powers from the moment that *consent* is freely given'.[103] Moreover, with regard to the stabilization clauses, the same idea was pursued further. As these clauses had been freely accepted by the State, the Tribunal emphasized that they 'do not affect the principle of its sovereign legislative and regulatory powers, since it retains both in relation to those, whether nationals or foreigners, with whom it has not entered into such obligations, and that, in the present case, changes in the legislative and regulatory arrangements stipulated in the agreement simply cannot be invoked against the other contracting party'.[104] This was the same as what in the *Texaco* award was described as the distinction between 'enjoyment and exercise' of sovereignty.[105]

Similar views are expressed by several writers. Thus, Professor Weil emphasizes that by concluding contracts with foreign companies 'un Etat, loin de limiter sa souveraineté, ne fait que l'exercer . . .'.[106] Elsewhere, the author elaborates further:

> La thèse de 'inaliénabilité des prérogatives de souveraineté' comporte une certaine part de tautologie, toute la question étant précisement de savoir si l'Etat *peut* ou non renoncer valablement à certains éléments de sa compétence. Cette thèse se fonde au surplus sur une conception quelque peu dépassée de la souveraineté: il y a longtemps que l'on sait que c'est précisément par une *manifestation* de sa souveraineté que l'Etat *peut* se lier par un traité ou un contrat, et l'on ne voit pas pourquoi il en irait autrement de l'engagement de l'Etat de renoncer à exercer telle ou telle de ses prérogatives: le principe *Pacta sunt servanda* n'est pas une négation de la souveraineté. L'argument tiré du caractère soi-disant inaliénable de la souveraineté ne dépasse donc guère le stade des explications purement verbales.[107]

In discussing the notion of permanent sovereignty over natural resources,

[102] Ibid., 475.
[103] *International Legal Materials*, 21 (1982), at p. 735 (emphasis added).
[104] Ibid., pp. 735–6.
[105] 53 ILR at pp. 481–2.
[106] Weil, loc. cit. above (n. 22), at p. 122.
[107] Weil, 'Les Clauses de stabilisation ou d'intangibilité insérées dans les accords de développement économique', *Mélanges Rousseau* (1975), pp. 302, 324 (emphasis added). Similar argument has been relied on by many others. See, for instance, Fischer, op. cit. above (n. 67), at p. 410; Greenwood, loc. cit. above (n. 67), at p. 61; Higgins, loc. cit. above (n. 89), at p. 311; Kojanec, loc. cit. above (n. 16), at p. 338; Kissam and Leach, 'Sovereign Expropriation of Property and Abrogation of Concession Contracts', *Fordham Law Review*, 28 (1959–60), pp. 177, 199; Kronfol, op. cit. above (n. 86), p. 83; Shawcross, 'Problems of Foreign Investment in International Law', *Recueil des cours*, 102 (1961–I), pp. 335, 351; Schwarzenberger, 'The Protection of British Property Abroad', *Current Legal Problems*, 5 (1952), pp. 295, 313.

Dr J.-F. Lalive goes so far as to suggest that it might even 'vider la souveraineté de son contenu puisqu'un Etat ne pourrait plus s'engager durablement et valablement . . .'.[108]

As reflected in the above examples, the subjective viewpoint emphasizes the ability of a sovereign to bind itself. It relies on the assumptions that a State has the 'capacity' or 'power', so that it 'can' or 'may' conclude contracts and hence contractual obligations are actually a 'manifestation' of sovereignty, not its negation. The objective point of view perceives sovereignty in opposite terms. As an example one could cite the argument of the Government of Iran concerning the nationalization of the Anglo-Iranian Oil Company in 1951. In the so-called 'hot oil' litigation that followed before a Japanese Court, it was claimed successfully that:

> The Nationalization Law . . . naturally superseded the Concession Agreement and rendered it no longer valid. It was in the *exercise* of the sovereignty of an independent State that Iran enacted her industrial nationalization Law . . .[109]

The objective view emphasizes the sovereign's right to expropriate property, 'including contractual rights previously granted by itself', as was held by the ICSID Tribunal in the *AMCO* case.[110] If taken to its extreme, this would imply that a State may revoke its contracts at will.

A central feature of the legal discourse is that the opposing arguments tend to go in circles. A power of a sovereign to terminate contracts is turned into its power to conclude them, or *vice versa*. Facing this difficulty, tribunals may be tempted to avoid adopting a particular view on principle.[111] These problems are epitomized in the *Aminoil* arbitration. There the company pursued a predominantly subjective approach. It argued with regard to the stabilization clauses that, by 'exercising' its sovereignty, the host State had renounced its right of nationalization for a period of time.[112] The Government claimed the opposite.[113] Though it was the latter view which

[108] Lalive, 'Un Grand arbitrage pétrolier entre un gouvernement et deux sociétés privées étrangères', *Clunet*, 104 (1977), pp. 319, 343.

[109] *Anglo-Iranian Oil Co* v. *Idemitsu Kosan Kabushiki Kaisha*, District Court of Tokyo, 1953, 20 ILR 305, 307 (emphasis added); for a similar argument made on behalf of Iran before the International Court of Justice, see *Anglo-Iranian Oil Co.* case, *ICJ Pleadings*, 1952, at pp. 495–7.

[110] *International Legal Materials*, 24 (1985), at p. 1029.

[111] For instance by proceduralizing the issues, cf. Koskenniemi, loc. cit. above (n. 90), at p. 98.

[112] 'Just as a right in general to nationalize or to expropriate may be admitted to exist as a power of the State, it is submitted that the *exercise* of this right may be renounced for a period by virtue of the same sovereign power. Such a renunciation is a choice of means by the State as to the way in which it will exercise its powers—not a denial that such powers exist. When this course is elected—as clearly is the case in a contract with a foreign private party containing a guarantee or stabilization clause—it must be given effect. Good faith and respect for rights thus granted demand no less': *Pleadings* (Book 1), Aminoil Memorial, 2 June 1980, vol. I (text), p. 57 (emphasis sustained, footnote omitted).

[113] In considering the legality of the Nationalization Law (No. 124 of 1977), it emphasized sovereign prerogatives under constitutional law and the right to nationalize under international law, if the conditions of public interest, non-discrimination and the payment of compensation are fulfilled: *Pleadings* (Book 5), Government's Counter-Memorial, December 1980, pp. 133–484. On the matter of contractual undertakings it was stated: 'If the Government, acting in good faith, considers it to be in the best interests of the State to take over a private company operating within the State—whether it is in contractual relationship with that company or not—then the Government may do so, providing that it complies

finally prevailed, an element of ambiguity remains on the Tribunal's position on principle. It tried to pursue a kind of intermediate line, putting forward rather peculiar and unconvincing arguments as to the parties' intentions.[114]

Upon closer analysis of the subjective argument, the question arises as to how the binding force of contracts can be justified solely by reference to the will of the sovereign.[115] In terms of juridical logic, even if a State 'can' conclude contracts, it does not follow that it 'ought' not to revoke them. On the contrary, the opposite—that 'ought' implies 'can'—would be widely accepted.[116] Consequently, even if one characterizes the conclusion of a contract as an 'exercise' of sovereignty, the problem of its binding force still remains.

While the conclusions derived from the 'exercise' of sovereignty remain ambiguous, it does not mean that they should be ignored. Although uncertain, they are symptomatic and suggest that the phenomenon of State contracting involves issues of social morality requiring legal responses. That is, in the modern world it is accepted that power entails responsibility and this aspect gains further significance when States enter into contracts with private parties as a matter of large-scale social practice. However, to take these considerations into account requires a less technical approach.

Finally, it should be noted that the realms of subjective and objective arguments of sovereignty are not confined to isolated doctrinal argument but reflect corresponding viewpoints on related issues. What follows is the division of arbitral practice into two sets of cases with different responses on whether unilateral terminations of contracts should be considered internationally unlawful acts or not. Basically, this divison of views implies that there are two different contract models involved. The subjective approach is related to classical contract thinking, usually known as the will-theory of contracts. Indeed, the preoccupation with the aspect of the 'competence' or 'power' of a sovereign to conclude contracts, at the expense of more substantive legal issues, suggests that the will-theory is assumed as the self-evident starting point. A more objectivist emphasis of sovereignty, not limiting it to a power merely to conclude contracts, but considering it also as the basis for their lawful termination, forces one to a somewhat different view of contrac-

with its own constitutional requirements and with the requirements of international law . . . To this act of a sovereign government, the private company cannot oppose its contractual rights, entered into thirty years previously by the Ruler of a country which was then under foreign protection. This is so even if such rights are bolstered up by a clause (such as Article 17 of the original colonial-type 1948 Concession Agreement) declaring that they are to endure for the life of the contract, unless the private company agrees otherwise': ibid., p. 144.

[114] 66 ILR at p. 589.

[115] See generally Fitzmaurice, 'Some Problems Regarding the Formal Sources of International Law', *Symbolae Verzijl* (1958), pp. 153 ff.; Lauterpacht, *The Function of Law in International Community* (1933), pp. 407–23; more closely related to the present area, see also Verhoeven, 'Droit international des contrats et droit des gens', *Revue belge de droit international*, 14 (1978–9), pp. 209, 220, note 18. Therein similar difficulties are identified *vis-à-vis* the attempts to establish the international status of a private party through a unilateral contractual recognition of a State.

[116] On the latter, see Atiyah, *Promises, Morals and Law* (1981), pp. 155–7.

tual obligations, with less emphasis on the will of the parties. This is more appropriate to what is known as the reliance-theory of contracts.

V. Control over Natural Resources

The discussion of State sovereignty requires a special comment on the question of natural resources. The struggle over their control is probably best known to international law through the concept of 'permanent sovereignty over natural resources'. Since it first emerged in 1952, the notion has been one of the most frequently employed legal precepts in the debate on the relations between host States and transnational companies. Its origin and evolution owe much to the United Nations Resolutions.[117] Particular mention should be made of Resolutions 1803 (XVII) of 14 December 1962,[118] 3021 (S-VI) of 1 May 1974 (Declaration on the Establishment of a New International Economic Order)[119] and 3281 (XXIX) of 12 December 1974 (Charter of Economic Rights and Duties of States).[120] The latter two instruments consider permanent sovereignty within a wider context of economic and legal relations, whose reform has been vigorously advocated by developing countries. One should note, however, that the Charter, whilst in many respects reflecting the present customary law, has not gained full recognition as regards its treatment of foreign investment. In the hope of achieving a general consensus and compromise, Resolution 1803 is usually seen to represent a more broadly-based opinion.[121]

Although the UN Resolutions have provided the main medium for the propagation of the notion of permanent sovereignty, reference should also

[117] The first one was Resolution 626 (VII) of 21 December 1952, which stated that 'the rights of peoples freely to use and exploit their natural wealth and resources is inherent in their sovereignty and is in accordance with the purposes and principles of the Charter of the United Nations'. For detailed accounts of the UN resolutions, see Gess, 'Permanent Sovereignty Over Natural Resources', *International and Comparative Law Quarterly*, 13 (1964), pp. 398 ff.; Rosenberg, *Le Principe de souveraineté des États sur leurs ressources naturelles* (1983), pp. 100–224; Chowdhury, 'Permanent Sovereignty Over Natural Resources', in Hussain and Chowdhury (eds.), *Permanent Sovereignty Over Natural Resources. Principle and Practice* (1984), pp. 1 ff.

[118] Reproduced in *International Legal Materials*, 2 (1963), p. 223.

[119] Reproduced in ibid., 13 (1974), p. 715.

[120] Reproduced in ibid., 14 (1975), p. 251.

[121] *Aminoil* award, 66 ILR 546, 588; *Revere Copper*, 56 ILR 258, 279; *Sedco, Inc.* v. *National Iranian Oil Company and the Islamic Republic of Iran*, Iran-United States Claims Tribunal, interlocutory award No. ITC 59–129–3 of 27 March 1986, Chamber Three (Mangård, Brower, Ansari), *Iran-US Claims Tribunal Reports*, vol. 10, pp. 180, 186; *Amoco International Finance Corp.*, Award, ibid., vol. 15, at p. 223, para. 116. The controversy has been focused on Art. 2(2)(*c*) of the Charter, concerning expropriation. Though it provides for appropriate compensation, no reference other than to the law of a host State is made. In the roll-call vote this provision was given 104 in favour to 16 against, with 6 abstentions, whereas the Charter was adopted by 118 to 6, with 10 abstentions. For a close scrutiny of the voting patterns, see *Texaco* award, 53 ILR at pp. 487–93. In addition, authors have had doubts about its legal value. For instance, Brownlie, 'Legal Status of Natural Resources in International Law (Some Aspects)', *Recueil des cours*, 162 (1979–I), pp. 245, 268, refers to its 'strong programmatic, political and didactic flavour'. See also, Virally, 'La Charte des droits et devoirs économiques des Etats', *Annuaire français de droit international*, 1974, pp. 57, 68–70.

be made to other instruments such as the two International Human Rights Covenants of 1966, which clearly embrace the concept of permanent sovereignty over natural resources.[122] The human rights aspect ('people's rights') perceives the notion as part of the history of decolonization and parallel to the principle of national self-determination.[123]

There is no doubt nowadays that the concept of permanent sovereignty has been incorporated as a principle of international law. The uncertainty lies rather in its impact on the body of traditional international law. What are the so-called corollary rights? Faced with this question one may be inclined to either of two extremes—to minimize or maximize its legal content. On the one hand, it has been shown above that emphasis on the conclusion of contracts as an 'exercise' of permanent sovereignty causes the concept to become marginalized to the extent that it becomes almost meaningless. On the other hand, some have considered it as a peremptory rule of law (*jus cogens*).[124] This view—if adopted—would indeed give it legal relevance, but it has not gained sufficient support in practice.[125]

If the two 'extremes' are excluded, the meaning of permanent sovereignty appears to be difficult to define. In fact, any kind of stipulative definition of it seems quite out of place. This may not be very surprising in an area such as the one under discussion, which, for more than two decades, has been a real battlefield of legal ideas. Hence, the notion is often described in fairly broad terms.[126] Rather than defining the issue specifically,

[122] International Covenant on Economic, Social and Cultural Rights, Art. 1, para. 2; International Covenant on Civil and Political Rights, Art. 1, para. 2: 'All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation based upon the principal of mutual benefit, and international law. In no case may a people be deprived of their own means of subsistence': reproduced in Brownlie, *Basic Documents in International Law* (3rd edn., 1983), pp. 258, 270. The principle is incorporated also in the Vienna Convention on Succession of States in respect of Treaties, 23 August 1978, Art. 13, reproduced in *American Journal of International Law*, 72 (1978), p. 971.

[123] Res. 1314 (XIII) of 12 December 1958 mentions it as 'a basic constituent' of the right to self-determination; also Resolution 3281 (XXIX) of 15 January 1975, Art. 1 (the Charter of Economic Rights and Duties of States). For an elaboration on this perspective in general, see Muchlinski, 'The Right to Economic Self-Determination', *Essays for Clive Schmithoff* (1983), pp. 73 ff.; Rosenberg, op. cit. above (n. 117), pp. 131–48.

[124] Jiménez de Aréchaga, loc. cit. above (n. 33), at p. 297; also Giardina, 'State Contracts: National Versus International Law', *Italian Yearbook of International Law*, 5 (1980–1), pp. 147, 164–5.

[125] For instance, see *Aminoil* case, *International Legal Materials*, 21 (1982), at p. 1021. The most elaborate discussion on the question may be found in the *Texaco* award. Interestingly, the Arbitrator did not reject the *jus cogens* aspect outright, but regarded it in temporal terms. Thus the relevant criterion was whether the State was 'alienated'—over a period of time—from its natural resources. However, this was found not to be the case here: 53 *ILR* at 482.

[126] The report of the Secretary-General on permanent sovereignty over natural resources, 25 February 1985, expresses the central idea, stating that the principle 'has been understood to imply the freedom of each country to dispose of its natural resources in accordance with its priorities, policies and objectives. It is also taken for granted that a country's natural resources shall be used to make the optimal contribution to national economic development: E/C. 7/1985/8 p. 4, para. 2; Brownlie, loc. cit. above (n. 121), at p. 271: 'Loosely speaking, permanent sovereignty is the assertion of the acquired rights of the host state, which are not defeasible by contract or, perhaps, even by international agreement'; Hossain and Chowdhury (eds.), *Permanent Sovereignty over Natural Resources*, vol. 13 (1984): 'At the core of the concept of permanent sovereignty is the inherent and overriding right of a state to control and dispose of the natural resources in its territory for the benefit of its own people.'

Resolution 1803 merely mentions nationalization, expropriation and compensation in this context (section 4). Moreover, it provides that 'foreign investment agreements freely entered into by, or between, sovereign States shall be observed in good faith . . .' (section 8).[127] It has been suggested that the real significance of the concept of permanent sovereignty can only be understood by examining its treatment on a case by case basis.[128] This is, in fact, the approach adopted in contemporary arbitral practice. Two questions arise in this context. The first concerns the scope of the notion of permanent sovereignty. The second relates to its actual implications in terms of law, which is considered further below.[129]

(a) *The Scope of Permanent Sovereignty over Natural Resources*

The question of who controls natural resources is a central issue in any discussion thereon. The concept of permanent sovereignty expresses the idea that natural resources should be controlled by the State in which they are located. The emphasis on the right to exercise permanent sovereignty stems from the past economic and political history of most developing countries. Since the process of decolonization, in particular, the shift of controlling power in favour of host States has been witnessed very often in favour of take-overs of foreign-owned activities in natural resource production. Many of the leading cases in recent arbitral practice arise out of this classic situation (for instance, *Texaco*,[130] *Liamco*,[131] *Aminoil*,[132] *BP*,[133] *Revere Copper*[134]). No arbitral tribunal has ever doubted that such situations give rise to issues within the scope of the concept of permanent sovereignty, although the views on the substantive legal consequences of this may vary. Conversely, certain activities can be readily excluded from the penumbra of the permanent sovereignty concept, namely those which do not directly relate to natural resources, such as certain types of manufacturing (*Benvenuti and Bonfant*[135]), various aspects of tourism (*SPP (Middle East) Ltd.* v. *Egypt* (*Pyramid Oasis)*[136] and *AMCO Asia*[137]) or

[127] This heterogeneity of elements within a single instrument results from the necessity of compromise between opposing interests. For a further discussion, see especially Rosenberg, op. cit. above (n. 117), pp. 209 ff.; also Sornarajah, op. cit. above (n. 75), at p. 121.

[128] Schachter, *Sharing of World's Resources* (1977), p. 125.

[129] p. 347.

[130] 53 ILR 389.

[131] 62 ILR 140.

[132] 66 ILR 546.

[133] 53 ILR 296.

[134] 56 ILR 258.

[135] *International Legal Materials*, 21 (1982), p. 740.

[136] Ibid. 22 (1983), p. 752.

[137] Ibid. 24 (1985), p. 1022. In this award Resolution 1803 of 1962 was mentioned, but clearly only as general evidence of the fundamental right to nationalize, which the award discussed *obiter*: ibid. at p. 1029.

transport and telecommunications (*RCA* v. *Czechoslovakia*;[138] *RCA* v. *China*[139]).

However, any attempt to narrow the scope of the notion further is considerably more difficult. On the other hand, it would seem inappropriate to extend the notion indiscriminately to all cases related to natural resources.

It is arguable that the notion of permanent sovereignty properly applies only to situations concerning control over the production itself—in other words, to what in business jargon are called 'upstream' rather than 'downstream' activities. One reason to restrict the notion thus may be found in the structural characteristics of international law. Production activities are usually (but not inevitably) located on the territory of a single State. Consequently, natural resource production is most susceptible to the exertion of entire legal (and political) control by that State. In other cases, such as transport or marketing, the activities do not necessarily take place within a single sovereign State. For this reason alone, any attempt to exert permanent sovereignty over 'all economic activities' (Charter of Economic Rights and Duties of States, Article 2 (1)) could certainly be perceived as 'too much of a good thing',[140] and might result in a clash between two States both purporting to exercise sovereignty.

Moreover, the treatment of 'downstream' activities as something beyond the proper scope of permanent sovereignty has support in the law of sovereign immunities. There are recent cases which seem to imply that a similarly narrow scope is appropriate, albeit not mandatory, in drawing the distinction between public acts (*jure imperii*) and private acts (*jure gestionis*) of States. Accordingly, in disputes closely related to production activities a plea of sovereign immunity may succeed, whereas in cases of sale of natural resources it has been refused in both European[141] and American

[138] *American Journal of International Law*, 30 (1936), p. 523.

[139] Ibid., p. 535.

[140] Stanford, 'International Law and Foreign Investment', in Macdonald, Johnston and Morris (eds.), *International Law and Policy of Human Welfare* (1978), pp. 471, 478.

[141] In the *National Iranian Oil Company Revenues from Oil Sales* case, Federal Republic of Germany, Federal Constitutional Court, 12 April 1983, 65 ILR 215, 221, the Court ruled: 'The funds had arisen in connection with *sales agreements* and therefore not in the course of sovereign activity' (emphasis added). A similar approach is reflected in the *National Iranian Oil Company Pipelines Contracts* case, Superior Provincial Court (Oberlandesgericht) of Frankfurt am Main, 4 May 1982, 65 ILR 212, 214. Referring to 'oil related activities', the defendant invoked sovereign immunity. In accordance with Res. 1803 of 1962, it was argued, the exploitation of oil was assigned to the 'inner sphere of sovereignty'. The Court, apparently considering that the various stages in the oil business are legally relevant, rejected the plea 'for the simple reason that the present case does not involve the *actual exploitation of oil resources* by the defendant in the attachment proceedings. The parties are in dispute over the financial performance of contracts for the building of oil and gas pipelines. In this respect, moreover, the defendant contracted with the plaintiff on a purely private commercial basis (contracts of work). It did not carry out any oil-related activities on a sovereign basis. The conclusion of the contracts for oil and gas pipelines was at most a preliminary step or a sequel to possible sovereign activity' (emphasis added). One may also mention the French decision in *Chilean Copper Corp.* v. *Braden Copper Co.*, 29 November 1972, Tribunal de grande instance de Paris, *International Legal Materials*, 12 (1973), pp. 182, 188. Following the nationalization of El Teniente copper mine, Braden had attached the proceeds of sales by the Chilean Copper Corp., to which its assets had been transferred. Chilean Copper

Court practice.[142] Although it was commonplace during the 1960s and 70s to nationalize or re-negotiate concessions relating to production activities, this did not threaten the position of transnational corporations in other areas such as marketing. Business has continued, even between the same parties, although often it is conducted somewhat differently.[143] In economic terms the distinction is valid, particularly with regard to the oil industry. It is axiomatic that whoever controls oil production controls the oil market. While States are not reluctant to share in any extra gains derived from their involvement in marketing, their primary focus has been to control production. Oil production has been the key to determining the price of oil.[144] Thus, it is—broadly speaking—at the 'upper' end of the process that the strong governmental interests lie. The involvement of foreign companies in the marketing function merely increases the price. It follows that the confrontation of two strongly opposed interests, typical in traditional concessions, is often far removed in the case of sales agreements.

Arbitral practice tends to follow that of the Courts in assuming a restrictive approach to the notion of permanent sovereignty. In the *AGIP* case, decided by an ICSID Tribunal, an Italian company which entered into an oil distribution agreement with the Government of the Congo in January 1974 was nationalized in April 1975. The Tribunal did not refer to the concept of permanent sovereignty over natural resources.[145] Nor was the

moved to vacate the attachment and invoked sovereign immunity. The Court stated that 'for the carrying out of its purpose the Chilean Copper Corporation proceeds specially in international transactions according to the ways and forms of private law of business; that thus the *contracts of sale* signed with Trefimetaux and the Groupement d'Importation des Metaux exclude any recourse to the methods which are usually connected with the public power . . .' (emphasis added).

[142] A highly complicated situation arose in *International Association of Machinists and Aerospace Workers* v. *Organization of Petroleum Exporting Countries et al.*, United States, Court of Appeals, Ninth Circuit, 6 July 1981, amended, 24 July 1981, 66 ILR 413. In this case the plaintiff brought an action against OPEC and its member States alleging that their price setting activities had violated United States anti-trust laws. The action against the member States had been dismissed by the District Court (63 ILR at 284) on the ground that control over natural resources is primarily a governmental function and as such entitled to sovereign immunity. The decision was confirmed, but the Court of Appeals preferred to base it on the act of State doctrine. It stated (p. 417) *inter alia*: 'The importance of the alleged price-fixing activity to the OPEC Nations cannot be ignored. Oil revenues represent their only significant source of income. Consideration of their sovereignty cannot be separated from their near total dependence upon oil. We find that these concerns are appropriately addressed by application of the act of State doctrine.' The case has been followed in *In the Matter of the Complaint of Sedco, Inc.*, US District Court for the Southern District of Texas, 1982, *International Legal Materials*, 21 (1982), pp. 318, 325 (emphasis added). It was ruled: 'The Court must regard carefully a sovereign's conduct with respect to its natural wealth. A very basic attribute of sovereignty is the control over its mineral resources and *short of actually selling these resources on the world market*, decisions and conduct concerning them are uniquely governmental in nature . . . Because the nature of Pemex' act in determining the extent of Mexico's natural resources was uniquely sovereign, this Court finds that the commercial activity exception to the FSIA, [sect.] 1605 (a)(2), is inapplicable to the facts presented by this case.'

[143] See generally, *Transnational Corporations in World Development: Third Survey* (1983), pp. 197, 209; Hossain, *Law and Policy in Petroleum Development* (1979), p. 40; Wälde, 'Third World Mineral Development in Crisis', *Journal of World Trade Law*, 19 (1985), pp. 3, 24–5: 'A characteristic feature of many compensation settlements is the continued presence of the nationalized investor, albeit in the role of a contractor supplying management, services and purchasing the output.'

[144] Luard, *The Management of the World Economy* (1983), p. 151.

[145] For a more comprehensive discussion of the case, see below, n. 159.

notion mentioned in the *Aramco* or *Sapphire* cases. The dispute in the former, although involving a traditional oil concession, did not concern the production itself; it was emphasized that the validity of the concession was not questioned, and that the dispute was 'strictly confined to the right of transportation by sea'.[146] The *Sapphire* case also concerned an oil concession agreement, concluded between the National Iranian Oil Company (NIOC) and a Canadian company in June 1958. The agreement distinguished between two periods: the first concerned prospecting activities and the second the extraction and sale of oil.[147] The project did not last into the second period as the disputes arose during the early stage of oil prospecting. By the end of 1958 NIOC had started claiming that prior consent was needed for every operation, which claim the court found contrary to the letter and spirit of the agreement. NIOC made baseless complaints and adopted an entirely negative attitude to the project. It also refused to take into consideration the expenses already incurred by the concessionaire. NIOC's conduct was held to constitute a flagrant breach of contract.[148]

From the point of view of permanent sovereignty it is arguable that prospecting activities are at most a 'preliminary step', prior to the actual production.[149] While it may be that in purely commercial terms natural resource activities form a unified whole, from the point of view of host States various stages may be perceived differently. In general the involvement of foreign companies in oil prospecting has not met with much discouragement from governments, at least in recent times. Foreign involvement in production, on the other hand, has been more problematic, as the State practice relating to large-scale nationalizations and re-negotiations of production activities from the middle of the 1960s up until 1980 suggests.[150] The fact that neither the *Aramco* nor the *Sapphire* award includes any explicit reference to the concept of permanent sovereignty is striking considering the dates of the awards (decided in 1958 and 1963

[146] 27 ILR at pp. 144–5, 177.

[147] 35 ILR at p. 137.

[148] Ibid., pp. 178–80.

[149] Cf. *National Iranian Oil Company Pipelines Contracts* case, above, n. 141; in the enforcement proceedings following the *Sapphire* award, NIOC's plea for sovereign immunity did not succeed. See *NV Cabolet* v. *National Iranian Oil Company*, Court of Appeal, The Hague, 28 November 1968, *International Legal Materials*, 9 (1970), p. 152. On the other hand, *In the Matter of the Complaint of Sedco*, loc. cit. above (n. 142), which also concerned oil exploration activities, sovereign immunity was granted. One may notice, however, that the dispute took place in the highly sensitive circumstances following the 1979 oil disaster in the Bay of Campeche which polluted the beaches of Texas. For a critical analysis of the case, see Delaume, 'Economic Development and Sovereign Immunity', *American Journal of International Law*, 79 (1985), pp. 319, 326–9.

[150] Since the late 1970s many of the Latin American countries, such as Brazil, Argentina and Chile, have awarded contracts for oil exploration to foreign companies. In Vietnam, also, exploration contracts with foreign companies have been negotiated. In Sri Lanka and Syria, where the States have retained their monopolies on petroleum exploration, such contracts have been signed with Western companies. The same has taken place in China and India. See *Permanent Sovereignty Over Natural Resources*, Report of the Secretary-General of 14 March 1979, E/C. 7/99, pp. 9–10; Report of 7 May 1981, E/C. 7/119, pp. 9–10; on the variation of interests depending on the stages of petroleum activities, see Hossain, op. cit. above (n. 143), at pp. 43–54.

respectively). Resolution 626 (VII) of 21 December 1952, the first United Nations instrument on the matter, had been passed well before the dates of these awards. In contrast, at least two municipal courts had by then referred to it in dealing with the classic case of nationalization of foreign-owned production activities.[151]

The main aim of the notion of permanent sovereignty has been to maintain national control over natural resources. It is sometimes regarded as a corollary to the principle of national self-determination. On a restrictive view, it would be difficult to disagree with the suggestion that the substitution of one private exploiter for another may be an exercise of permanent sovereignty over natural resources. However, viewed more broadly, in the final analysis the resource remains under the control of a foreign corporation, albeit quite possibly on terms which are enhanced from the State's point of view. In this sense, at least, such contractual abrogations appear alien to the exercise of permanent sovereignty over natural resources.

In general, such incidents happen not infrequently,[152] although the present discussion is confined to the scope of the notion of permanent sovereignty alone. A good example in this respect is the *Aramco* award. One

[151] This had occurred in the so-called 'hot oil' litigation following the Iranian nationalization of the Anglo-Iranian Oil Company. See *Anglo-Iranian Oil Company* v. *Idemitsu Kosan Kabushiki Kaisha*, High Court of Tokyo, 1953, 20 ILR at p. 313; *Anglo-Iranian Oil Company* v. *SUPOR Company*, Civil Court of Rome, 13 September 1954, 22 ILR 23, 40–1, where it was ruled: 'The General Assembly of the United Nations, at its meeting of December 21, 1952—less than one month after the date of the Iranian Law of November 26, 1952—passed a Resolution recommending that individual States should not be prevented from exploiting their natural resources. It is evident that the decision of the United Nations at that meeting, taking into consideration the date when it was taken and the international situation to which it related, constitutes a clear recognition of the international lawfulness of the Persian Nationalization Laws.' Six months after its adoption, the Resolution had also been invoked by Guatemala in support of her nationalization of a subsidiary of the United Fruit Company: Hyde, 'Permanent Sovereignty Over Natural Wealth and Resources', *American Journal of International Law*, 50 (1956), p. 854.

[152] In such a context it was stated in *Radio Corporation of America* v. *Czechoslovakia, American Journal of International Law*, 30 (1936), pp. 523, 534: 'When a public institution enters into an agreement with a private person or a private company, it must be assumed that the institution has intended by this agreement to benefit its citizens. But that this expectation sometimes proves to fail in not giving the country as large a profit as was expected, cannot be considered sufficient reason for releasing that public institution from its obligations as signatory of said agreement.' In *Radio Corporation of America* v. *China*, 13 April 1935 (*Hamel, Hubert, Furrer*), ibid., pp. 535, 541, the Tribunal emphasized 'utmost *bona fides*' in the case of a partnership or joint venture, and continued: 'Such a contract is violated if one of the parties initiates a direct joint activity on parallel lines with a competing third party. Even if not explicitly stipulated, such an obligation will then have to be implied.' In *Mojzesz Lubelski* v. *The State of Burundi, Jurisprudence du Port d'Anvers* (1969), p. 82, a three-year concession had been granted in 1965, which conferred on the company a right to buy gold and diamonds on the territory of the State. Only two weeks later this was cancelled by an administrative decision. The concession was considered to be an administrative contract governed by the law of Burundi. While the Tribunal admitted that its powers did not entail the review of the motives for cancellation (p. 91), it did take notice (p. 85) that '[l]e seul motif donné était l'existence "d'une autre convention passée entre le gouvernement précédent et un groupe de personnes" '. As an extreme case one could mention the situation where the very power to annul a contract would lie outside a government. With regard to such a situation the Permanent Court of International Justice has stated that 'the safeguard against ill-considered expropriation which exists when the initiative is in the hands of a State, which can only expropriate for reasons of public utility, was seriously impaired': *Mavrommatis Jerusalem Concessions* case, judgment of 26 March 1925, *PCIJ*, Series A, No. 5, p. 40.

should emphasize that in this case it was not simply a question of a confrontation of national interests with those of the company. The essence of the dispute was that a new contract concerning oil transportation had been concluded subsequently with another foreigner, Mr Aristotle Onassis.[153] It is possible that similar facts lay behind the *Sapphire* dispute as well, although the Tribunal did not elaborate on this point.[154] In the *Valentine Petroleum* arbitration, Valentine Petroleum and Chemical Corporation, an American company, signed a ten-year agreement with the Government of Haiti for exploration for oil and the establishment of oil refineries and petrochemical plants in Haiti.[155] The company was granted a contract of guarantee by the US Agency for International Development. In October 1964 there were press reports that the agreement had been annulled by a decree and that a similar concession had been granted to another foreign person, Sheikh Muhamed Fayed, for a period of fifty years. Shortly afterwards the staff of the company were arrested and subsequently returned to the United States.[156] Under the contract of guarantee the company submitted a claim against the Agency and the matter was referred to arbitration. The company's losses were held to be recoverable because the Tribunal found that the abrogation of the contract was wrongful in that it constituted expropriation of an arbitrary nature.[157] A similar situation appears in the *Letco* case. The ICSID Tribunal's *obiter dictum* suggests that had the unilateral reduction of the forest concession area been considered a nationalization, which was not at issue, the bona fide public purpose would have been missing. The Tribunal noted that the areas from which the plaintiff was ousted were given to other foreign companies which were run by people who were 'good friends' of the Liberian authorities. There was no indication of any 'stated policy on the part of the Liberian Government to take concessions of this kind into public ownership for the public good'.[158]

[153] The Tribunal noted: 'The Onassis Agreement is a contract, concluded by the State with a private individual or corporation . . . The second concessionaire cannot rely on any use, guaranteed to the public, of Aramco's Concession, but is a private individual who intervenes in his own interest in order to draw as much profit as possible from the vast and expensive operations of the first concessionaire. The creation of a state fleet is not at issue here. Satco tankships are not State Vessels. They belong to Mr Onassis and his companies and are merely registered in Saudi Arabia . . . ': 27 ILR at pp. 217–18.

[154] It found that 'while Sapphire International faithfully carried out its obligations, the defendant deliberately broke its own, by hiding behind reasons which it must have known were without validity, and once again taking up a wholly negative attitude and failing to perform duties which were clearly defined in the agreement of the parties. Such an attitude is a further breach of the obligations undertaken by NIOC, since the parties had expressly agreed to carry out their contract according to the rules of good faith and in a spirit of good will': 35 ILR at p. 181. Moreover, it was pointed out with respect to the lack of loyal collaboration on the part of NIOC: 'This behaviour was likely to convince the plaintiff that NIOC intended to avoid the contract by continuous and systematic obstruction, but without wishing to be the first one to denounce it': ibid., p. 185.

[155] 44 ILR at p. 79. This was the first arbitration within the United State Investment Guaranty Program.

[156] Ibid., pp. 82–5.

[157] Ibid., p. 89. Under the Investment Guaranty Program anticipated profits are excluded from recovery, though they may be included in the total claim against the expropriating State.

[158] *Liberian Eastern Timber Co. (Letco)* v. *Liberia*, *International Legal Materials*, 26 (1987), at p. 665.

(b) *The Effect of Permanent Sovereignty over Natural Resources*

If the present issues were to be approached from the viewpoint of the law of sovereign immunity, they could be reduced to a single question, that is, whether or not to grant immunity to the State. Likewise, simple solutions could be sought by attempting to analyse the situation in terms of lawful and unlawful acts and categories thereof. For instance, one may sometimes doubt the genuine necessity to take expropriatory action on the ground of the 'public interest' of a State.[159] To take another example, some acts might be considered arbitrary, particularly if the sole purpose of contract abrogation is to substitute one foreign company for another.[160] However, in an international system of sovereign States, which (by definition) are presumed to know what is in their own interest, difficulties readily arise if standards of lawful behaviour are based on grounds which are open to wide interpretation.[161] Consequently, in order to give legal effect to the above classifications, a more modest search, for differences of degree rather than overall substance, would seem more appropriate. The most convenient approach would then be to take account of the above distinctions as elements which influence the process of evaluation of compensation, along the lines of what might be called 'private law' and 'public law' approaches.

The 'private law' approach implies giving legal effect to the parties' expectations, as determined by the terms of their contract. Consequently, the recovery would not only involve the so-called *damnum emergens* but often the loss of profits would also be allowed. The parties' will as contractors is the focal point of consideration. As it was expressed in the *Amco* award: 'Whatever compensation the investor can hope to get, that means at the least that the nature of its rights was changed against its will . . .'.[162] Apart from this case, which also involved clearly unlawful acts, one should

[159] In the *AMCO Asia* case the Tribunal was at pains to emphasize that the State action must be 'a true nationalization . . . which aims to protect or to promote the public interest'. It did not, however, elaborate on this in substantive terms. Instead, it was found later, on formal grounds however, that the action was totally irregular, that is, that it had not been based on any legislative act by the Indonesian Parliament: ibid. 24 (1985), at pp. 1029–30. In the *AGIP* award similar considerations emerged. While it was not ruled that the decision of the State to revoke its contract and nationalize the oil distribution activities was taken in the absence of public interest, the Tribunal's approach suggests a salient critique of the measures. It was pointed out that to satisfy the public interest of the State, it was not necessary to resort to nationalization. Stressing that there was a contractual relationship between the State and AGIP, the Tribunal stated: 'Furthermore, the Government, which was not without responsibility for the economic difficulties experienced by the Company, was not legally in a position from the point of view of commercial law to act in such radical fashion against the Company. If it wished to protect its interests as a shareholder, the Government should have respected the legal procedures available to it, which in this case consisted either of having the board of directors call an extraordinary meeting of the Company, or regulating the judicial authority to pronounce its dissolution . . .': ibid. 21 (1982), at pp. 735, 737.

[160] Some writers have indicated that a State action which merely terminates a contract should be considered separate from nationalization. In this sense, Lalive, loc. cit. above (n. 20), at p. 58; similarly Schachter, loc. cit. above (n. 76), pp. 311–12, suggests, though with hesitation, that a simple non-performance of a contract without providing any legal remedy could constitute an arbitrary act.

[161] Above, n. 84.

[162] *International Legal Materials*, 24 (1985), at p. 1032.

refer generally to those disputes which, in terms of the above analysis, fall outside the ambit of the concept of permanent sovereignty over natural resources—in other words, disputes completely unrelated to natural resource activities, or falling outside the production activities themselves. In this respect, it suffices to say that there is a tendency in recent legal practice to compensate for the loss of future profits though not always to the full extent.

The 'public law' model would apply to long-term agreements concerning natural resource production, i.e. cases which lie at the heart of the concept of permanent sovereignty. According to this approach, not only the terms of a contract, but also wider considerations, relating to the dependence of national development on the natural resources, would be taken into account. The practical implication is that the recovery of lost profits is more restricted. The public law model is reflected in the *Liamco* and *Aminoil* awards in particular. Although the latter award may not be entirely unproblematic from a technical viewpoint, given the difficulties of reconciling the Tribunal's reasoning on quantification with the actual figures, the Tribunal nonetheless appears to have substantially accepted the validity of the contentions of the Kuwaiti Government in its policy argument:

> Oil, together with natural gas, is the only natural resource possessed by the desert State of Kuwait. It is a finite resource, upon which the welfare and prosperity of the people in large part depends. It proved too precious to be left in the hands of a private entrepreneur, concerned primarily with maximising its profits . . .[163]

Moreover, it continued:

> For the Tribunal to award compensation (or rather, damages) on the basis claimed by Aminoil would be as burdensome to the Government as it would be for the Government to relinquish all control or sovereignty over its natural resources. It would be tantamount to depriving the Nation for ever of all right over its oil reserves. This could not be a correct interpretation of international law, in a post-colonial era.[164]

Mindful of a similar approach in the *Liamco* award, in contrast to the *Texaco* case, one should also draw attention to the report of 7 May 1981 by the Secretary-General of the United Nations, which expresses a favourable comment *vis-à-vis* the former:

> The award in the *TEXACO/CALASIATIC* v. *The Libyan Arab Jamahiriya* case is still a subject of discussion. While some authorities note the arbitrator's reliance on international law, the principle of investment security and sanctity of contract, others note that the award is at variance with the opinion of States which regard State contracts with foreigners as being subject exclusively to national law. On the other hand, the award in the *LIAMCO* v. *The Libyan Arab Jamahiriya* case may

[163] *Pleadings* (Book 5), Government's Counter-Memorial, p. 151.
[164] Ibid., p. 160.

indicate a solution whereby the principle of permanent sovereignty over natural resources is affirmed.[165]

As has been shown above, contemporary international law recognizes that control over natural resources entails particularly strong considerations of public interest. Generally speaking, the ways in which the relations of 'public' and 'private' interests are arranged in law vary in cases from one society to another. Nevertheless, what has been discussed above with regard to international law is not wholly devoid of analogies in national law. In the area of State contracts one should mention particularly the notions of 'administrative' and 'public' contracts known in Continental and Anglo-American law respectively. Both cases reflect a necessary accommodation of public or State interests and the interests of individuals. Because of the involvement of public authorities such contracts have different characteristics as compared to ordinary private contracts. Notable among these is the right of the administration to terminate its contract unilaterally when public interests so require.[166] Also, there is a tendency in French doctrine, apparently of fairly recent origin, to consider mining concessions as administrative contracts.[167] The same view has been assumed in German doctrine as well.[168] Moreover, the public interest aspect may be reflected, to a greater or lesser degree, in the restriction of available remedies. In his classic work on public contracts, Professor Mitchell notes on English law:

Finally, it must be remembered that the cause of interference with the contract is public necessity. While therefore it is perhaps reasonable to claim that the contractor should not lose, equally he should not be allowed to profit from the situation. In view of these factors, and of the cause of the interference with the contract, it might suffice if compensation were allowed solely for actual loss suffered without any

[165] E/C. 7/119, p. 28, para. 83.

[166] This may have been recognized by statutory provisions (Federal Republic of Germany, Italy, France) or generally acknowledged even in the absence of such provisions (France, Belgium). In Britain and the United States the same is achieved by the standard 'break'-clauses, which are regularly included in substantial government contracts. In the United States such a clause may even be incorporated by the operation of law if it has been wrongly omitted: Turpin, 'Public Contracts', *Encyclopaedia of Comparative Law*, vol. 7, chap. 4, pp. 56–7.

[167] de Laubadère, Moderne and Delvolvé, *Traité des contrats administratifs*, vol. 1 (1983), p. 332 ('La réponse ne peut être qu'affirmative'). The writers refer to the obligatory application of exorbitant contract terms imposed by public authorities as well as the exorbitant regime governing the concessions. Though they do not fall technically within the traditional categories of 'public service' or 'public works' concessions, the policy reason for the doctrinal development lies in the increased public interest in the matter: ibid., p. 330. Cf. *Texaco* case, where the role of stabilization clauses, in particular, was emphasized as an indication of the parties' intention not to refer to the doctrine of administrative contracts: 53 ILR at p. 478; the same conclusion was reached in the *Aramco* award on the ground that an oil concession was not technically a public service concession: 27 ILR at p. 169. On the other hand, the expert opinion submitted by the claimant in the *BP* award characterized oil concessions as administrative contracts according to Libyan law: 53 ILR at p. 324. In other cases oil concessions have been considered to have a mixed private and public nature: *Liamco* case, 62 ILR at p. 169; *Sapphire* award, 35 ILR at p. 171.

[168] Nicolayson, *Bewilligung und Förderabgabe nach dem Bundesberggesetz: unter besonderer Berücksichtigung der Förderung von Erdöl und Erdgas* (1982), pp. 20–1, 28.

element for loss of expectation of profit, whether the interference takes the form of a termination of an existing contract or of a considerable variation of one.[169]

In the United States, too, the recovery of lost future profits is excluded in the case of 'termination for convenience' clauses in public contracts.[170] On this point, the French doctrine seems to afford greater protection of private interests, for it would normally allow the recovery of loss of profit.[171]

In this article diverse but closely related matters have been discussed. At the outset, some of the assumptions which underlie the internationalization of State contracts were examined. This was followed by a brief survey of stabilization clauses and certain aspects concerning their efficacy. Finally, the notions of sovereignty and of permanent sovereignty over natural resources were dealt with. All of these separate issues underpin the discourse on the binding force of State contracts. However, it is unwise to consider them in isolation. In the event of a dispute, they generate simultaneous problems, and all these problems, in the final analysis, revolve around the central issue of how the law should accommodate, with justice, the conflict of interests between society as a whole and particular or sectional interests.

[169] Mitchell, *The Contracts of Public Authorities* (1954), p. 229; see also Higgins, 'The Availability of Damages for Reliance by a Government on Executive Necessity', *Festschrift Mann* (1977), pp. 21 ff.

[170] Turpin, loc. cit. above (n. 166), at p. 57; for more detailed studies, see Perlman and Goodrich, 'Termination for Convenience Settlements—The Government's Limited Payment for Cancellation of Contracts', *Public Contract Law Journal*, 10 (1978), pp. 1, 28; Andrews and Peacock, 'Terminations: An Outline of the Parties' Rights and Remedies', ibid. 11 (1980), pp. 269, 282.

[171] de Laubadère, Moderne and Delvolvé, *Traité des contrats administratifs*, vol. 2 (2nd edn., 1984), pp. 667–71; Vedel and Delvolvé, *Droit administratif* (9th edn., 1984), p. 356, comment on this point: 'Il semble que des éléments de moralité interviennent parfois dans la jurisprudence du Conseil d'Etat. Le *damnum emergens* est seul indemnisable quand c'est un événement indépendant de la volonté de l'Administration qui a motivé la résiliation. Au contraire, dans la mesure où il s'agit d'une nouvelle appréciation par l'Administration des besoins du service, la jurisprudence se montre plus large dans l'octroi des indemnités.'