

# THE LAW OF NATURAL RESOURCES DEVELOPMENT: AGREEMENTS BETWEEN DEVELOPING COUNTRIES AND FOREIGN INVESTORS

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## I. INTRODUCTION: THE POLICY AND ECONOMIC CONTEXTS OF ECONOMIC DEVELOPMENT AGREEMENTS

Since the question of the law governing natural resource development agreements between developing countries and international corporate investors was raised by Lord McNair in a seminal article, in 1957,<sup>1</sup> the literature on the subject has grown tremendously.<sup>2</sup> My excuse for adding to this body of literature is that the many changes which have occurred in the organic structure of the world community, as well as in the internal organization of the developing countries whose natural resources are the subject of these agreements, have necessitated a review of the premises upon which Lord McNair based his conclusions.

Lord McNair advocated that economic development agreements between foreign investors and developing states, rich in natural resources but lacking capital or technology, should be governed by a system of general principles of law recognized by civilized states. This system of law, he asserted, is not to be considered a part of public international law *stricto sensu*, but a separate system of law, sharing with public international law "a common source of recruitment and inspiration."<sup>3</sup> He submitted that a consensus in line with his thesis was already emerging and that his article pro-

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1. McNair, *The General Principles of Law Recognized by Civilized Nations*, 33 *BRR. Y.B. INT'L L.* 1 (1957).

2. See generally Anderson & Coulson, *The Moslem Ruler and Contractual Obligations*, 33 *N.Y.U. L. REV.* 917 (1958); Kissam & Leach, *Sovereign Expropriation of Property and Abrogation of Concession Contracts*, 28 *FORDHAM L. REV.* 177 (1960); Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 *INST. PRIVATE INVESTMENT ABROAD* 5 (1960); Schwebel, *International Protection of Contractual Agreements*, 1959 *AM. SOC'Y INT'L L. PROC.* 266; Wadmond, *The Sanctity of Contract Between a Sovereign and a Foreign National*, 1957 *A.B.A. SECTION MIN. & NAT. RESOURCES L. PROC.* 177.

3. McNair, *supra* note 1, at 6.

posed "to take stock of the trend and to indicate the direction which in the best public interest it should follow."<sup>4</sup>

Lord McNair considered the following seven factors supportive of his thesis: (1) Such agreements have a "foreign element" because they are usually made between a government and a foreign corporation which owes its existence to the laws of a foreign state and derives its capital primarily from nationals of that state. (2) They are not simple contracts of sale, but involve a long-term commitment to invest large amounts of capital and technology in the development of the natural resources of the developing state. (3) They often involve the creation of rights which are not purely contractual but are more akin to property rights, such as the right to possess and exercise considerable authority over large areas of the territory of the developing state. (4) Such agreements often vest in the foreign corporation "certain rights of an unusual and semi-political character," such as freedom from certain taxes and import duties. (5) They sometimes involve the diplomatic efforts of the state of the investor. (6) The legal systems of the developing contracting state and the state of the investor "frequently have very little in common, either in content or in the stages of development." (7) The agreements frequently provide for arbitration of disputes in a manner that excludes the national courts of both parties.<sup>5</sup>

Arguably, few of these factors, even in 1957, were important enough to justify the removal of these agreements from the purview of the legal system of the host country. Whatever importance these factors may have commanded in 1957 has been diminished today by the profound changes in the world arena which have affected the economic and political status of the developing countries. Moreover, these countries, individually and collectively, have experienced internal changes which have affected both their agreements and therefore the law applicable to such agreements with foreign corporate investors.

When Lord McNair wrote in 1957, many of the present group of developing countries, whose natural resources are today the subject matter of economic development agreements, were still under colonial rule or, to some degree, the economic and political influence of one developed capital exporting country or another.<sup>6</sup> Real and

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4. *Id.* at 2.

5. *Id.* at 3-4.

6. This is reflected in the fact that between 1955 and 1976 about 86 countries, mostly Asian and African, have joined the United Nations.

imagined fears of "gunboat diplomacy," as well as the great economic and political powers of the international companies, combined to hold the economic nationalism of these countries in check. As a whole, they had not awakened to the importance and the role of their natural resources for their own political and economic development; if they had, they lacked the political solidarity and muscle needed to gain effective control over them.

The concept of permanent sovereignty of nations over their natural resources was first raised in the United Nations in 1952, in connection with the movement for economic development and political independence by the developing countries.<sup>7</sup> Thereafter, it came to be viewed as an aspect of human rights.<sup>8</sup> In 1958, the United Nations General Assembly established the Commission on Permanent Sovereignty Over National Resources and thus laid the foundation for a thorough study of the subject and its full impact on, and implications for, foreign investment in the natural resources of the developing countries.<sup>9</sup> After three full years of study and debate in different bodies of the United Nations system, the General Assembly passed resolution 1803 (XVII) of December 14, 1962 on Permanent Sovereignty of states Over their Natural Resources.<sup>10</sup> This resolution declared that "the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exer-

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7. See Integrated Economic Development and Commercial Agreements, G.A. Res. 523, 6 U.N. GAOR, Supp. (No. 20) 20, U.N. Doc. A/2119 (1952); Right to Exploit Freely Natural Wealth and Resources, G.A. Res. 626, 7 U.N. GAOR, Supp. (No. 20) 18, U.N. Doc. A/2361 (1952).

8. See Recommendations Concerning International Respect for the Right of Peoples and Nations to Self-determination, G.A. Res. 837, 9 U.N. GAOR, Supp. (No. 21) 21, U.N. Doc. A/2890 (1954); Declaration on the Granting of Independence to Colonial Countries and Peoples, G.A. Res. 1514, 15 U.N. GAOR, Supp. (No. 16) 66, U.N. Doc. A/4684 (1960).

9. Recommendations Concerning International Respect for the Right of Peoples and Nations to Self-determination, G.A. Res. 1314, 13 U.N. GAOR, Supp. (No. 18) 27, U.N. Doc. A/4090 (1958).

10. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR, Supp. (No. 17) 15, U.N. Doc. A/5217 (1962). The substance of this resolution was first discussed by the Commission on Permanent Sovereignty Over Natural Resources, 3 U.N. Commission on the Permanent Sovereignty Over Natural Resources (19th-33d mtgs.), U.N. Docs. A/AC.97/SR.19-SR.33 (1961), see Report of the Commission on Permanent Sovereignty over Natural Resources, 32 U.N. ESCOR, Annexes (Agenda Item 9), U.N. Doc. E/3511 & Add.1 [A/AC.97/13 & Add.1] (1961); then by the Economic and Social Council in its 32d Session (July 4-Aug. 4, 1961), 32 U.N. ESCOR (1177th-1179th, 1181st mtgs.) 172-77, 180-82, 187-89, U.N. Docs. E/SR.1177-SR.1179, E/SR.1181 (1961); and then by the Second Committee at its 798th through 821st, 841st to 842d, 845th to 846th, 848th, 850th to 861st, 864th, 876th, and 877th meetings (Sept. 19-Dec. 17, 1962), 17 U.N. GAOR, C.2, at 15-165, 270-74, 293-301, 313-17, 326-409, 430-31, 501, 507, U.N. Docs. A/C.2/SR.798-SR.877 (1962).

cised in the interest of their national development."<sup>11</sup> It also declared that the development and disposition of the natural resources, including the participation of foreign capital and technology, should take place in accordance with the rules and conditions laid down by the states.<sup>12</sup> In cases where foreign capital and technology have been invited to participate in the development, the relationship between the host state and the foreign investor should be governed by their agreement, the laws of the state, and international law.<sup>13</sup> Such agreements shall be observed in good faith, but can be abrogated by expropriation, nationalization, and requisitioning if necessary for the national interests of the states concerned, on payment of appropriate compensation.<sup>14</sup> Political independence—which has come to many peoples and lands since the end of the Second World War as a result of universal recognition of the right of political and economic self-determination—must therefore be seen as the most important factor in considering the legal status of economic development agreements.

Other developments in the United Nations system have been directed towards strengthening the sovereign independence of the developing countries, particularly with regard to the control over and disposition of their natural resources. This strengthening of control over their natural resources has given rise to the concept of the inalienable permanent sovereignty of states over those natural resources. Insofar as developing states have based their actions on this concept, the ideas of permanent ownership and inalienability implied in permanent sovereignty have been of paramount importance to them in organizing and regulating the development of their natural resources.

For our purposes, the impact of this resolution lies in its political significance. For the developing countries, it has formed the basis of their claim to control their natural resources. It was observed by many delegations in the several forums where the matter was discussed that the sovereign right of states over their natural resources had never previously been questioned.<sup>15</sup> However, its open

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11. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, para. 1, 17 U.N. GAOR, Supp. (No. 17) 15, U.N. Doc. A/5217 (1962).

12. *Id.* para. 2.

13. *Id.* para. 3.

14. *Id.* paras. 4, 8.

15. See Schwebel, *The Story of the U.N.'s Declaration on Permanent Sovereignty Over Natural Resources*, 49 A.B.A.J. 463 (1963); Gess, *Permanent Sovereignty Over Natural Resources*, 13 INT'L & COMP. L.Q. 398, 411 (1964).

and public declaration by the international community—in an atmosphere in which the newly independent developing countries felt that past and present practices of colonialism and other forms of subjugation had deprived them of their natural resources and wealth—was an invitation to them not only to re-establish their sovereignty where it was considered lost, but also to affirm it for the present and the future through the exercise of full ownership and control over those resources.

In subsequent resolutions on this subject the General Assembly has continued to reaffirm the principles enunciated in resolution 1803 (XVII) and further to elucidate their dimensions.<sup>16</sup> For example, in resolution 2158 (XXI) of November 25, 1966, while recognizing that foreign investment under proper governmental supervision can play an important role in the development of a country's natural resources, the General Assembly affirmed that the exploitation of natural resources in each country "shall always be conducted in accordance with national laws and regulations."<sup>17</sup> This trend, to subject natural resources development agreements and disputes arising from them entirely to local law and regulations, follows from the fact that the reference to international law, a compromise between the positions of the capital exporting and importing countries which had been carefully worked out in resolution 1803 (XVII), has been dropped.<sup>18</sup> The principle of nationalization, which is the means of safeguarding permanent sovereignty over natural resources, also implies that the expropriating state is entitled to determine the amount of possible compensation and the mode of payment, and that any disputes which may arise are to be settled in accordance with the national legislation of the state.<sup>19</sup> As could be expected, the

16. See Permanent Sovereignty Over Natural Resources, G.A. Res. 2158, 21 U.N. GAOR, Supp. (No. 16) 29, U.N. Doc. A/6316 (1966); Permanent Sovereignty Over Natural Resources, G.A. Res. 2386, 23 U.N. GAOR, Supp. (No. 18) 24, U.N. Doc. A/7218 (1968); Declaration on Principles of International Law Concerning Friendly Relations and Co-operation Among States in Accordance with the Charter of the United Nations, G.A. Res. 2625, 25 U.N. GAOR, Supp. (No. 28) 121, U.N. Doc. A/8028 (1970); Permanent Sovereignty Over Natural Resources of Developing Countries and Expansion of Domestic Sources of Accumulation for Economic Development, G.A. Res. 2692, 25 U.N. GAOR, Supp. (No. 28) 63, U.N. Doc. A/8028 (1970); Permanent Sovereignty Over Natural Resources of Developing Countries, G.A. Res. 3016, 27 U.N. GAOR, Supp. (No. 30) 48, U.N. Doc. A/8730 (1972); Permanent Sovereignty Over Natural Resources, G.A. Res. 3171, 28 U.N. GAOR, Supp. (No. 30) 52, U.N. Doc. A/9030 (1973). See also S.C. Res. 330, 28 U.N. SCOR 3, U.N. Doc. S/INF/29 (1973).

17. Permanent Sovereignty Over Natural Resources, G.A. Res. 2158, para. 4, 21 U.N. GAOR, Supp. (No. 16) 29, U.N. Doc. A/6316 (1966).

18. *Id.* para. 4; see also Schwebel, *supra* note 15.

19. See Permanent Sovereignty Over Natural Resources, G.A. Res. 3171, para. 3, 28 U.N. GAOR, Supp. (No. 30) 52, U.N. Doc. A/9030 (1973).



capital exporting countries have rejected this.

In a more comprehensive formulation of claims, expressed in terms of a new international economic order, the developing countries have again secured international recognition of their right to prescribe and apply norms for the development of their natural resources.

In 1972 the Group of 77, a group of developing countries, proposed to the third United Nations Conference on Trade and Development (UNCTAD) the drawing up of a "charter of economic duties and rights of states."<sup>20</sup> This proposal came as a result of the Group's conviction that the existing conditions governing international trade relations and policies were no longer adequate to secure the development objectives of the world economy, and particularly their own economies.<sup>21</sup> The proposal noted that the present international economic structure and practices have failed to bridge the gap between the rich and poor nations, and it called for a set of declarations of rights and duties of states, which could be transformed into an international document that states could invoke in asserting their rights.<sup>22</sup>

This objective was achieved at the Sixth Special Session of the United Nations where the General Assembly adopted, by large majorities, two resolutions: the Declaration on the Establishment of a New International Economic Order,<sup>23</sup> and a Program of Action<sup>24</sup> for its establishment. In the Declaration the members "[s]olemnly proclaim[ed] [their] united determination to work urgently for THE ESTABLISHMENT OF A NEW INTERNATIONAL ECONOMIC ORDER based on equity, sovereign equality, interdependence, common interest and cooperation among all States."<sup>25</sup> Finally, in December 1974, the General Assembly in regular session adopted the Charter of Economic Rights and Duties of States,<sup>26</sup> embodying the program of

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20. 3 UNCTAD, I Proceedings of the United Nations Conference on Trade and Development, para. 209, at 35, U.N. Doc. TD/180, Vol. I (1972). See UNCTAD Res. 45, *id.*, Annex I, at 58.

21. *Id.* at 35.

22. *Id.*

23. Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201, 6 Special Sess. U.N. GAOR, Supp. (No. 1) 3, U.N. Doc. A/9559 (1974).

24. Programme of Action on the Establishment of a New International Economic Order, G.A. Res. 3202, *id.* at 5.

25. Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201, preamble, *id.* at 3.

26. Charter of Economic Rights and Duties of States, G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1974) (adopted by a roll call vote of 120 to 6, with 10

action adopted in the Special Session.

As indicated earlier, the fundamental purpose of the Charter is to promote the establishment of a new international economic order which will constitute a binding international instrument for a new system of economic relations. Its scope is therefore extensive in coverage as well as far-reaching in its implications. It affirms and further expounds the generalized claims and counterclaims of the participants in the process of natural resource development. Article 2 provides as follows:

1. Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

2. Each State has the right:

(a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;

(b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, co-operate with other States in the exercise of the right set forth in this subparagraph;

(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.<sup>27</sup>

By emphasizing the authority of the host state's laws and policies over foreign investment in natural resource development, and over disputes arising from such investments, the Charter seeks to strengthen the sovereignty of states over their natural resources.

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abstentions, 29 U.N. GAOR (2315th mtg.) 44-45, U.N. Doc. A/PV.2315 (1974)).

27. 29 U.N. GAOR, Supp. (No. 31) at 52.

Like the many resolutions of the General Assembly subsequent to resolution 1803 (XVII),<sup>28</sup> the Charter leaves out any reference to international law with respect to the observance of agreements entered into between states and investors. Further, it confirms that the obligation to pay compensation for expropriation and the amount of compensation depend solely upon the expropriating state's laws and practices. The result, therefore, is to keep agreements between states and foreign investors within the purview of that state's law.

As would be expected, the Charter as adopted, like similar resolutions, did not meet with the approval of some important capital-exporting countries. The United States, West Germany, France, Japan, and the United Kingdom, while not opposed to the Charter in principle, each expressed dissatisfaction with its failure to provide for the observance of agreements in good faith, as well as for payment of compensation for expropriated property in accordance with international law.<sup>29</sup>

It is pertinent here to consider the effect of these developments with regard to their value in the United Nations system as international community prescriptions. The prescriptive value of United Nations resolutions has been considered by national and international tribunals and scholars.<sup>30</sup> The U.N. Charter provision which relegates resolutions of the General Assembly to mere recommendations<sup>31</sup> still forms the basis of the popular view that those resolutions cannot have any legal effect, but can at best serve as a moral force. However, there is a growing recognition that some species of General Assembly resolutions can constitute the best evidence of a consensus among states, or lack of it, with respect to particular issues of international law and policy.<sup>32</sup> The importance of this trend arises

28. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR, Supp. (No. 17) 15, U.N. Doc. A/5217 (1962).

29. See 6 Special Sess. U.N. GAOR (2229th mtg.) paras. 77-103, 103-115, 172-201, U.N. Doc. A/PV.2229 (1974); *id.* (2230th mtg.) paras. 37-55, U.N. Doc. A/PV.2230 (1974); *id.* (2231st mtg.) paras. 29-49, U.N. Doc. A/PV.2231 (1974).

30. *E.g.*, J. BRIERLY, *THE LAW OF NATIONS* 167-71 (6th ed. 1963); O. ASAMOAH, *THE LEGAL SIGNIFICANCE OF THE DECLARATIONS OF THE GENERAL ASSEMBLY OF THE UNITED NATIONS* 79-100 (1966); Schachter, *Scientific Advances and International Law Making*, 55 CALIF. L. REV. 423 (1967). For opinions of the International Court of Justice, see Advisory Opinion on Voting Procedure on Questions Relating to Reports and Petitions Concerning the Territory of South-West Africa, [1955] I.C.J. 67, 120-22 (Lauterpacht, J., separate opinion); South West Africa Cases, Second Phase, Judgment, [1966] I.C.J. 4, 50-51; *id.*, at 455-56 (Padilla Nervo, J., dissenting). For a U.S. court opinion, see *Diggs v. Shultz*, 470 F.2d 461 (D.C. Cir. 1972).

31. U.N. CHARTER art. 10.

32. See note 30 *supra*.



from the fact that the United Nations is today the most universal political organization, and is therefore the most important forum for measuring the degree of agreement among states in matters of international relations. Resolutions adopted by large majorities on important issues will carry a great deal of weight, especially if the majority is mixed. Similarly, resolutions in the form of declarations are customarily viewed by states as having both legal and moral significance, because they embody the convictions of the General Assembly, and, therefore, those of the states represented there, on fundamental issues.<sup>33</sup>

The resolutions on Permanent Sovereignty of states Over their Natural Resources<sup>34</sup> and the Charter on Economic Rights and Duties of States<sup>35</sup> meet the qualifications of that specie of United Nations resolutions which have legal as well as moral significance.<sup>36</sup> For example, resolution 1803 (XVII) was a declaration; it therefore can be deemed to represent the convictions of a majority of the member states of the United Nations.<sup>37</sup> Also, it was passed by a large majority which included both capital importing and capital exporting states and has been viewed as a balanced accommodation of the conflicting interests of the two groups of countries.<sup>38</sup> In the case of the resolution on the Charter of Economic Rights and Duties of States, admittedly some of its provisions were opposed by major capital exporting countries. However, the importance of the resolution is not for that reason diminished; each of the objecting capital exporting countries supported it in principle.<sup>39</sup> In any case, it is supported by a sizable majority of states.<sup>40</sup>

These developments within the United Nations system, which strengthen the ownership and control by the developing countries over their natural resources, have been preceded and complemented by developments in other international arenas. Such arenas comprise the ever-growing number of natural resources producing organizations which have served and continue to serve as the nurseries for

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33. See Schacter, *The Evolving International Law of Development*, 15 COLUM. J. TRANSNAT'L L. 1, 4 (1976).

34. E.g., Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR, Supp. (No. 17) 15, U.N. Doc. A/5217 (1962). See note 16 *supra*.

35. Charter of Economic Rights and Duties of States, G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1974).

36. See generally Gess, *supra* note 15, at 408-17; Schacter, *supra* note 33, at 7-9.

37. Schwebel, *supra* note 15, at 469.

38. See Schwebel, *supra* note 15.

39. See generally materials cited note 29 *supra*.

40. See note 26 *supra*.

the formulation and firming of claims by member countries. The claims are designed to win and strengthen the member countries' sovereignty over their natural resources. The success of the Oil Producing and Exporting Countries' (OPEC) united front in securing member countries' control of their oil resources has no doubt motivated other natural resources producers.<sup>41</sup> The common objective of these organizations is to coordinate and unify the policies of member countries. Their efforts have largely resulted in changes in the patterns of natural resource development agreements between themselves and foreign investors.<sup>42</sup>

OPEC, the most successful of the producer organizations, provides the best demonstration of this trend. For example, during its Sixteenth Conference in Vienna, June 24-25, 1968, OPEC adopted Resolution XVI.90,<sup>43</sup> in which it recommended some principles upon which member countries should base their petroleum policy. In summary, these principles were, *inter alia*:

1. *On Mode of Development*: that each member country should make every effort to develop its own resources; if foreign investor participation is desired, the member so desiring shall seek to retain the greatest possible measure of participation. New agreements as well as the existing ones shall be open for periodic revision.

2. *On Participation*: that each member country should acquire reasonable participation in the ownership of producing companies on the grounds of the principle of changing circumstances.

3. *On Fiscal Guarantees*: that each government may at its discretion give a guarantee of fiscal stability, but such guarantees notwithstanding, the government must initiate renegotiations of the financial terms of the agreement whenever a situation arises in which the investor is reaping "excessively high net earnings after

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41. The primary producers' associations and their dates of establishment are as follows: OPEC (1960), African Groundnut Council (1964), Intergovernmental Council of Copper Exporting Countries (1967), Asian Coconut Community (1968), Pepper Community (no date given), Union of Banana Exporting Countries (1974), Association of Natural Rubber Producing Countries (1974), International Association of Mercury Producers (1974), International Bauxite Association (1974), Council of South-East Asia Lumber Producers' Association (1975), African Timber Producers (1975), Association of Iron Ore Exporting Countries (1975), Primary Tungsten Producers' Association (1975), Jute International (in process). 13 U.N. MONTHLY CHRONICLE, No. 9, at 28 (Oct. 1976).

42. See generally Symposium, *The Changing Framework of Concession Agreements and the Oil Industry*, 7 VAND. J. TRANSNAT'L L. 279 (1974); Symposium, *Mining the Resources of the Third World: From Concession Agreements to Service Contracts*, 1973 AM. SOC'Y INT'L L. PROC. 227.

43. Declaratory Statement of Petroleum Policy in Member Countries, OPEC Res. XVI.90, reprinted in 7 INT'L LEGAL MAT'LS 1183 (1968).

taxes"; that is, "net profits after taxes which are significantly in excess, during any twelve-month period, of the level of net earnings the reasonable expectation of which would have been sufficient to induce the [investor to make the investment initially]."

4. *On Settlement of Disputes*: that all disputes arising between the governments and the investors shall fall exclusively within the jurisdiction of the competent national courts or the specialized regional courts, as and when established.<sup>44</sup>

The norms or principles expressed in this resolution and others by producer organizations, in addition to the several resolutions in the United Nations system, have provided both the legal and political basis for the actions of states, developed<sup>45</sup> and developing, with respect to the development of their natural resources. The result, as far as the developing countries are concerned, has been marked changes in the economic and legal structure of agreements under which foreign investment participates in the development of their natural resources.<sup>46</sup> These changes are relevant in considering or reconsidering the proper law of economic development agreements. Now the rule rather than the exception, these changes pertain to various aspects of the agreements.

The legal characterization of the agreements has changed from concession to other forms, such as service contracts, joint ventures, work contracts, and so forth.<sup>47</sup> Some writers have expressed the view that this change is not as important as it may look, that in substantive rights and obligations the new kinds of agreements do not differ from concessions.<sup>48</sup> These writers ignore the most important legal and political fact of the change: the affirmation of the state's ownership of its natural resources. Almost all the developing countries have established these legal and political facts by comprehensive or special legislation pertaining to their natural resources, or by constitutional provisions which provide for state or public ownership of natural resources.<sup>49</sup> Even in respect of preexisting concessionary

44. *Id.*, reprinted in 7 INT'L LEGAL MAT'LS at 1184-86.

45. For recent developments in the United Kingdom, Canada, and Australia, see Permanent Sovereignty Over Natural Resources, Report of the Secretary-General, [29 U.N. GAOR] (Sept. 20, 1974) (mimeo only) 12-14, U.N. Doc. A/9716 (1974). This Report is a supplement to Permanent Sovereignty Over Natural Resources, Report of the Secretary General, [55 U.N. ESCOR] (Oct. 3, 1973) (mimeo only), U.N. Doc. E/5425 & Add. 1.

46. See generally materials cited note 42 *supra*.

47. See *id.*; see also Smith & Wells, *Mineral Agreements in Developing Countries: Structures and Substance*, 69 AM. J. INT'L L. 560 (1975).

48. See, e.g., Smith & Wells, *supra* note 47.

49. H. CATTAN, *THE EVOLUTION OF OIL CONCESSIONS IN THE MIDDLE EAST AND NORTH AFRICA* 84-85 (1967); see, e.g., OPEC Res. XVI. 90, *supra* note 43.

rights, concessionaires have come to accept the retroactive effect of such legislation or constitutional provisions. For example, in a recent agreement between five oil-producing countries and the major international oil companies, the latter agreed to yield to the countries twenty-five percent participation in their profits. The companies also recognized that the unproduced oil reserves in the concession area were the national assets of the countries and that the companies were therefore not entitled to be compensated for the oil.<sup>50</sup>

Concessions which grant ownership rights to the concessionaire are now inconsistent with the right of permanent sovereignty of the state.<sup>51</sup> Even if the economic benefits to the parties are the same in both concessions and other forms of agreements, the political value of the change to the states is important and substantial.<sup>52</sup>

The current agreements are shorter in duration and cover much smaller territories; moreover, relinquishment by the investor of substantial portions of the original area covered by the agreements is now a common provision.<sup>53</sup> The old form of concessions, which granted extensive and absolute ownership rights as well as extensive control over a large territory of the granting state, is no longer politically or economically acceptable to the developing countries.<sup>54</sup> Consequently, agreements such as those considered by Lord McNair are rare today. They have been either renegotiated or expropriated by developing countries in the exercise of their permanent sovereignty over their natural resources.<sup>55</sup>

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50. The agreement was entered into in New York on October 5, 1972, between Abu Dhabi, Iraq, Kuwait, Qatar, Saudi Arabia, and the major oil companies. Permanent Sovereignty Over Natural Resources, Report of the Secretary-General, [29 U.N. GAOR] (Sept. 20, 1974) (mimeo only) 4, U.N. Doc. A/9716 (1974).

51. See generally Smith & Wells, *supra* note 47; W. FRIEDMANN & J. BÉGUIN, JOINT INTERNATIONAL BUSINESS VENTURES IN DEVELOPING COUNTRIES 22 (1971).

52. The political survival of the governments in many developing countries may depend on how well they are deemed to manage the national patrimony. Calling an arrangement a "concession" rather than giving it a label indicating state ownership, especially when the laws of the state require such a label, would spell the doom of the government.

53. See H. CATTAN, *supra* note 49, at 84-85; see also OPEC Res. XVI. 90, *supra* note 43.

54. See materials cited note 42 *supra*.

55. Nationalization usually follows refusal by the foreign investor to renegotiate old agreements. In OPEC Res. XVI. 90, *supra* note 43, the organization recommended to its members, among other things, that agreements with foreign companies should be open to renegotiation at predetermined periods on the grounds of changing circumstances. *Id.*, reprinted in 7 INT'L LEGAL MAT'LS at 1185. OPEC has backed the nationalization of companies which refuse to renegotiate or which have failed to reach agreement with particular countries. See OPEC Res. XXIV. 135, reprinted in 10 INT'L LEGAL MAT'LS 1082 (1971). For example, OPEC backed Libya when it nationalized certain oil companies after a breakdown of negotia-



The pattern of sharing of financial benefits in natural resource development agreements has changed. With respect to petroleum and other important natural resources development agreements, the producing countries are no longer interested just in collecting taxes and royalties; they now seek, and have acquired by agreement or unilateral action, equity participation in the operating companies.<sup>56</sup> As to the exemption from certain taxes and dues which Lord McNair also considered important, any exemption is now generally a part of a carefully worked out financial arrangement with the investor.<sup>57</sup>

The laws of the developing countries regulating natural resources have been progressively modernized and are now more easily ascertainable. One of the alleged problems of applying the law of a developing country to an economic development agreement was that the legal system of a developing country was too unsophisticated to regulate complex economic agreements, that such legal system was often not close in content or stage of development to those of the investors.<sup>58</sup> Even if this assertion had any validity at one time, which is doubtful, given the fact that most of the developing countries have at one time or another shared common legal association with some sophisticated legal system, the position has changed significantly in the last decades as developing countries reform their laws and enact new legislation, particularly in the area of their natural resources development.<sup>59</sup>

These changes in the internal legal arrangements of developing countries for exploiting their natural resources signify their acceptance of the now universally acknowledged challenge that social and economic development is primarily their responsibility.<sup>60</sup> The

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tions on government participation. OPEC Res. XXV. 159, *reprinted in* 13 INT'L LEGAL MAT'LS 221 (1973).

56. This is the policy declared in OPEC Res. XVI. 90, *supra* note 43. See note 55 *supra*. See also Smith & Wells, *supra* note 47. The Report of the Secretary General on Permanent Sovereignty Over Natural Resources shows that as of 1974, the OPEC members have all acquired between 55-100% participation in or ownership of their respective oil industries. [29 U.N. GAOR] (Sept. 20, 1974) (mimeo only) 4, U.N. Doc. A/9716.

57. See H. CATTAN *supra* note 49, at 63.

58. McNair, *supra* note 1, at 3.

59. See generally The Status of Permanent Sovereignty Over Natural Wealth and Resources, 3 Commission on Permanent Sovereignty Over Natural Resources, U.N. Doc. A/AC.97/5 Rev. 2 [E/3511] (1962); Investment Laws and Regulations in Africa, U.N. Economic Commission for Africa, U.N. Doc. E/CN.14/INR/28/Rev. 2 (1965).

60. The Charter of Algiers, adopted by the Ministerial Meeting of 77 Developing Countries, Oct. 24, 1967, U.N. Doc. MM/77/1/20, *reprinted in* 7 INT'L LEGAL MAT'LS 177, 180 (1968). The same sentiment was expressed by many delegations during debates in the Sixth and



changes also reflect the countries' belief in the important role that natural resources are expected to play in their efforts.<sup>61</sup> President Boumediene of Algeria summed up the complexity of the situation of the developing countries in his speech at the United Nations Sixth Special Session in 1974:

In reality, in the race now commencing between industrialized countries, which intend to accumulate maximum profits in order to be able to dispense as soon as possible with the raw materials of the developing countries and, on the other hand, the developing countries themselves, which intend to profit from the ultimatum which has been clearly served upon them in order to lay the foundations of their development and their economic liberation, the problem of raw materials can no longer be formulated in purely commercial terms. It exhibits all the aspects of a veritable strategic problem which will determine the survival of the producing countries and must be subjected to the most determined vigilance.<sup>62</sup>

The legal and political contexts of modern natural resource development agreements which have been surveyed in the preceding pages form the background against which the problem of the proper legal order of such agreements can be more accurately described. As has been indicated, this background has changed many of the factors that seemed important when Lord McNair first pointed to the problem.

The purpose of this article, therefore, is to examine the current trend of agreements for the development of natural resources of the developing countries. As Lord McNair had noticed, and in view of the current practices of the participants in these agreements, the consensus on the proper law points towards the unquestionable and comprehensive control of the local laws and regulations of developing countries.

## II. THE NATURE OF THE PROBLEM

Every agreement must be concluded within the framework of a legal system. No agreement can exist in a vacuum. It is in the context of such a legal system that the parties to the agreement

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Seventh Special Sessions of the General Assembly.

61. See generally *Natural Resources of Developing Countries: Investigation, Development and Rational Utilization*, U.N. Doc. E/4608/Rev. 1, ST/ECA/122 (1970); *Mineral Resources Development with Particular Reference to the Developing Countries*, ST/ECA/123 & Corr. 1 (1970); OPEC Res. XVI. 90, reprinted in 7 INT'L LEGAL MAT'LS 1183 (1968).

62. 6 Special Sess. U.N. GAOR (2208th mtg.) 10-11, U.N. Doc. A/PV. 2208 (1974).

assume rights and obligations. The legal system provides the norms by which genuine differences of opinion about the meaning of the terms of the agreement can be resolved. The legal system draws the outer boundaries of the relevant community's policies beyond which the parties cannot legally go, and within which other matters of interest to the community must be resolved, such as the capacity of the parties, validity, performance, termination, and remedies. In private contracts having international connections with more than one jurisdiction, the proper determination of the relevant legal system is achieved by the application of the forum state's relevant prescriptions and policies. The purpose of such determination is to select, from among interested jurisdictions, one whose dominant interest justifies the application of its substantive rules for the resolution of the conflict which has arisen. With few exceptions,<sup>63</sup> the general practice among states is to give the greatest weight to the express or implied will of the parties.<sup>64</sup> In the absence of an express provision by the parties, common practice is to resort to certain presumptions as guides to determining the proper law of the agreement, for example, the law of the place where the agreement is made (*lex loci contractus*) or where it is to be performed (*lex loci solutionis*).<sup>65</sup> Where such presumptions are dispelled by other considerations, such as the subject matter of the contract, the nature of the parties, and so forth, the proper law is the law which the parties are deemed by the forum decision-maker to have intended.

The question which is posed by agreements between a developing country and a foreign investor for the development of that country's natural resources is whether the proper legal system to govern such agreements should be determined by the procedures and practices which have been described above. The answer to this question will depend on whether the purposes for such inquiry are the same as for private contracts having international connections. It is submitted that the purposes are not the same. A contract between a state and a private party has two aspects: the state is a contracting party as well as a sovereign. By common practice of states, a contractor is deemed to contract under its own law, and its rights and obligations are determined under that law.<sup>66</sup> As a sovereign having

63. See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 6, 188 (1971).

64. J. MORRIS, DICEY AND MORRIS ON THE CONFLICT OF LAWS 721-48 (9th ed. 1973).

65. *Id.* at 742-46; see RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 188(2)-(3); see also *id.* §§ 189, 196, 205-206.

66. See Case Concerning the Payment of Various Serbian Loans Issued in France,

control and authority over people and events within its jurisdiction, as well as having total responsibility for the well-being of its body politic, a state can make sovereign decisions and take sovereign actions within its jurisdiction which may unilaterally change the expectations freely created by its agreement with the private party. Such unilateral action may involve issues of whether the state has negotiated away its sovereign rights in the agreement. To this extent, the question is one of interpretation, subject to a presumption in favor of the state's sovereign power of action.

Unless the unilateral action of the state is alleged to be a breach of some international obligation or to be contrary to any rules of international law, including the general principles of law in the sense of article 38(1)(c) of the Statute of the International Court of Justice, a dispute arising therefrom cannot be resolved by any legal system other than that of the state. When a state's unilateral action is challenged, a question arises as to which international obligation or international law has been violated. The inquiry is directed towards ascertaining international norms by which to evaluate the state's action in reference to its responsibility under international law. Such responsibility arises from the fact that the state is a sovereign having duties and obligations under international law. If asked in that context, the question does not focus on the "proper law" of the agreement which the state has unilaterally breached in the exercise of its sovereign powers. The true issue of the "proper law" of the agreement between a state and a foreign investor can properly arise only in the context of the state's actions as a contractor. The proper international norms governing the responsibility of the state for a breach of international law or obligation has nothing to do with the proper law of the agreement between the state and a foreign investor unless, of course, the agreement is concluded under international law.

Many scholarly discussions dealing with the "proper law" to apply in economic development agreements confuse the distinction between disputes which raise the issue of the proper law of the agreement only and those which raise issues of state responsibility under international law. They concentrate on the latter, where tensions run high and clarification of issues becomes clouded with passion. It must be remembered that many contractual investment

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[1929] P.C.I.J., ser. A, No. 20, at 42; *Case Concerning Brazilian Federal Loans Issued in France*, [1929] P.C.I.J., ser. A, No. 21, at 121.

disputes involve legitimate and honest differences of opinion in which the parties' efforts to find a solution are marked by friendly and sincere search for a reasonable understanding.<sup>67</sup>

For reasons which have become obvious, the search for the proper law of economic development agreements between private entities must be more limited than in cases of agreements having international connections. General principles of conflict of laws common in the practices of states may help in the search for agreements having international connections but cannot be controlling.<sup>68</sup> The search for the proper law of agreements between states and private entities, especially when the solution is to be arrived at by implication, must be limited to a choice between the legal order of the contracting state and international law.<sup>69</sup> In no case known to this writer has another state made a claim to regulate such contracts. In fact, such a claim would be deemed objectionable on the grounds of the sovereign immunity of states.<sup>70</sup> This is not, of course, to say that states may never conclude agreements with private entities or other states which call for the application of another state's law.<sup>71</sup> Where there exists an express agreement of the state there is no doctrinal or other reason for objection. A state may, in the exercise of its sovereign authority, conclude such contracts. In such cases, common interest in freedom of contract compels the fullest recognition of the parties' autonomy unless such a result is prohibited by a state's fundamental policies<sup>72</sup> or in some way offends some international community policy.<sup>73</sup>

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67. See, e.g., *Petroleum Dev. [Trucial Coast] Ltd. v. Sheikh of Abu Dhabi*, 18 I.L.R. 144 (1951), 1 INT'L & COMP. L.Q. 247 (1952); *Saudi Arabia v. Arabian Am. Oil Co. (ARAMCO)*, 27 I.L.R. 117 (1958); *Sapphire Int'l Petroleums Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136 (1963). In the ARAMCO arbitration, the friendly nature of the parties was evidenced in their memorials:

As shown by the memorials and oral arguments of both Parties, the present arbitration is a friendly one, whose purpose is to decide what is just and right in the dispute which has arisen between the Parties, so that they may resume and maintain the friendly and fruitful co-operation which has characterized their relations for nearly a quarter of a century.

27 I.L.R. at 135.

68. McNair, *supra* note 1, at 4-5.

69. *Id.* at 10; see Broches, *Choice-Of-Law Provisions In Contracts With Governments*, in PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, *INTERNATIONAL CONTRACTS: CHOICE OF LAW AND LANGUAGE* 64, 73 (1962); Delaume, *The Proper Law of Loans Concluded by International Persons: A Restatement and a Forecast*, 56 AM. J. INT'L L. 63, 68 (1962).

70. *Saudi Arabia v. Arabian Am. Oil Co.*, 27 I.L.R. at 155-56.

71. See, e.g., Mann, *Another Agreement between States under National Law?*, 68 AM. J. INT'L L. 490 (1974) (bilateral agreements governed by the domestic law of one state).

72. Such as a Calvo Clause or similar provision in the state's constitution. See note 85 *infra*.

73. E.g., *Jus Cogens*. Vienna Convention on the Law of Treaties, adopted May 22, 1969

Where there is a clear expression of intention in the agreement, no problem arises. It is when the agreement is either silent on the applicable law or makes only vague references about applicable law that opinions among scholars and decisionmakers diverge.

There is a misleading undercurrent influencing the discussions of the problem, especially by Western scholars. This undercurrent consists of an overemphasis of the need to protect the foreign investor. It is misleading because the assertions about the implied proper law of the contracts under consideration do not take a community view of the world. In the long run, this attitude may well injure the investor rather than protect him. The bases for the assertions by these scholars are wide-ranging. For instance, it is widely assumed that the decisionmakers of most grantor states are unsophisticated and cannot understand, much less determine, the complex issues involved in a modern economic development agreement. It is also claimed that, even if they have such sophistication, they are likely to be prejudiced against the foreign investors. It is further claimed that the laws of most developing countries are undeveloped to such an extent that those laws cannot provide rules for a proper interpretation of a complex modern economic development agreement.<sup>74</sup> One writer has actually suggested that Moslem law, which is the law of a significant part of the world, because it is technically addressed to Moslems<sup>75</sup> is incapable of general application and therefore cannot be appropriate to regulate rights and obligations under a modern economic development agreement between a Moslem state and a non-Moslem foreign investor.

Other expressions of concern for the foreign investor who is subject to the local authority of the contracting state allude to the improbability of the employment of gun-boat diplomacy to secure performance of contractual obligations by the developing states and suggest that this affords a reason to seek protection of the investor in other ways. As was pointed out by a recent *Wall Street Journal*

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U.N. Doc. A/CONF.39/27 (1971) (ratified by 26 nations as of July 1976—needs 35 ratifications to take effect).

74. See generally McNair, *supra* note 1, at 4; Broches, *The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 136 RECUEIL DES COURS (Hague Academy of International Law) 330, 387-95 (1972).

75. Anderson & Coulson, *supra* note 2, at 922. But see *Saudi Arabia v. Arabian Am. Oil Co.*, 27 I.L.R. at 162-65 (the tribunal found that Moslem law permitted the Imam, as the theocratic Ruler, to grant concessions to any investor in accordance with the Shari'ah).



editorial, "[i]n the 19th Century . . . 'cutting out expeditions' were almost routinely conducted against petty gangster governments."<sup>76</sup> When such expeditions were the accepted proper response, it is implied, the foreign investor had no concern that the local legal system would not adequately protect him, for his government stood behind him. Now that this form of protection is improbable,<sup>77</sup> some suggest, as an alternative, the elevation of the agreements under consideration to the plane of international law whereby the contracting state can incur direct international responsibility for the mere breach of such agreements.

### III. ASSERTIONS ABOUT APPLICABLE LAW IN CONCRETE SITUATIONS

#### A. *Agreements Containing Specific References to the Applicable Law*

Many modern natural resource development agreements contain provisions for dispute settlement which may or may not include specific reference to the law to be applied. The provisions appear in a number of forms which vary in accordance with the perceptions of the parties about one another's good faith, as well as the degree to which they are anxious to do business with one another.<sup>78</sup> The location of the natural resource and the nationality of the investors may also be important. In the final analysis, it is the ingenuity of the negotiators that counts.

In most cases it is the investor who is anxious to include a specific provision in the agreement. There are various reasons for this: the investor may need to be assured in advance that reasonable rules will be applied in interpreting the agreement and in determining the rights and obligations of the parties; he may also simply

76. *Flying High and Low*, Wall St. J., July 7, 1976, at 14, col. 1. Although the statement was made in quite a different context—the Israeli commando raid at Entebbe—most of the "expeditions" referred to were conducted for less humanitarian purposes.

77. This would seem to be so as a result of the prohibitions of such actions under the U.N. Charter. Referring to this prohibition in connection with the British and Iranian dispute over the nationalization of the Anglo-Iranian Oil Company, Dean Acheson said, "In simpler times and places armed intervention, known as 'gunboat diplomacy,' would have resolved this problem in favor of the stronger power, but the United Nations Charter put obstacles, to say the least, in the way of that." D. ACHESON, *PRESENT AT THE CREATION—MY YEARS AT THE STATE DEPARTMENT* 505 (1969).

78. Lord McNair observed that, "[o]ne can truly infer from these contracts—both from what they do say and from what they do not say—that the parties are groping after some legal system which is not the territorial law of either party." McNair, *supra* note 1, at 10.

want to "create an enclave status"<sup>79</sup> for the agreement and thus protect himself from future changes in the laws of the state. A recent study has indicated that this last reason dominates in recent resource development agreements between foreign investors and developing countries of the British Commonwealth of Nations.<sup>80</sup> Some practicing lawyers have pointed to the usual difficulties of negotiating dispute settlement provisions in modern agreements, particularly with developing countries. They point to the fact that it is "troublesome [for them] to justify provisions in an agreement which in effect exempt an investor from the operation of local law or [which] apply another law."<sup>81</sup> In those countries where laws prohibit submission of government agreements with foreign investors to any law other than their own, refusal to agree to a dispute settlement provision is not just a matter of reluctance or inconvenience, but of legal impossibility.<sup>82</sup>

Despite these difficulties, such provisions are inevitable in modern resource development agreements. Happily, the dilemma of a state which will not be able to attract the necessary foreign capital and know-how for the development of its natural resources unless it is willing to agree to a provision for the applicable law, has now been made less serious by the existence of the International Centre for the Settlement of Investment Disputes (ICSID) in Washington, D.C., established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.<sup>83</sup>

The most common forms of provision for the applicable law in modern economic development agreements may be generally classified as follows:

1. Those directing the application of the local law of the contracting state alone.
2. Those directing the application of principles of law com-

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79. Brown, *Choice of Law Provisions in Concession and Related Contracts*, 39 MOD. L. REV. 625 (1976).

80. See *id.*

81. Lipton, *Negotiating a Concession Agreement: From the Host Government Point of View*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN BLACK AFRICA 78, 78 (1975); see Walcott, *Corporate Objectives for Developing Mineral Properties in Africa*, in *id.* at 85, 88.

82. See notes 84-94 *infra* and accompanying text.

83. Done March 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159 (opened for signature Aug. 27, 1965; entered into force (U.S.) Oct. 14, 1966); see Vuylsteke, *Foreign Investment Protection and ICSID Arbitration*, 4 GA. J. INT'L & COMP. L. 343 (1974). See generally Lipton, *supra* note 72; Walcott, *supra* note 72. As of June 30, 1973, about 68 states had signed the Convention, and 65 of them had ratified it, see [1972/1973] ICSID, 7TH ANN. REP.

mon between the contracting state and the state or states of the investors.

3. Those directing the application of the law of the contracting state to one part of the agreement and international law to other parts.

4. Those directing the application of international law alone.

#### 1. PROVISIONS FOR THE APPLICATION OF NATIONAL LAW

As was previously stated, most producing grantor states now have comprehensive legislation relating to the exploitation of their natural resources.<sup>84</sup> They naturally intend that the policies they have expressed in such legislation, as well as in their general laws, should govern all agreements with private individuals and entities for the exploitation of their resources. Some developing countries have a definite policy which provides that an alien who is doing business within their jurisdictions must be subjected to the same laws as a national. These countries specifically prohibit the possibility of any choice of law in agreements with aliens. They do this through provisions in their constitutions or through their general laws. Examples of such prohibitions abound in the constitutions and laws of the Latin American countries where the so-called Calvo Doctrine has been generally accepted and faithfully followed.<sup>85</sup>

Outside Latin America, there is a growing tendency among the developing countries to prohibit the possibility of a choice of law

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84. See generally *The Status of Permanent Sovereignty Over Natural Wealth and Resources*, 3 Commission on Permanent Sovereignty Over Natural Resources, U.N. Doc. A/AC.97/5/Rev. 2 [E/3511] (1962); *Investment Laws and Regulations in Africa*, U.N. Economic Commission for Africa, U.N. Doc. E/CN.14/INR/28/Rev. 2 (1965).

85. Named after its architect, the Argentine jurist Carlos Calvo (1824-1906), the doctrine asserts that a foreigner doing business in another country is entitled to nondiscriminatory treatment only; and that by entering the country, he impliedly consents to be treated as a national of that country. The clause requires him to renounce his right to call on his own government for diplomatic protection. See generally D. SHEA, *THE CALVO CLAUSE* (1955). The attachment to the Calvo Clause by Latin American countries is so strong that they have collectively refused to sign the World Bank Group's Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *supra* note 83. As to the reasons for their refusal, see Wionczek, *A Latin American View*, in *HOW LATIN AMERICA VIEWS THE U.S. INVESTOR* 4 (1966). More recently, the Andean Pact nations—Ecuador, Bolivia, Chile, Colombia, Peru, and Venezuela—declared in Commission Decision 24 that “[n]o instrument concerning foreign investments or transfer of techniques shall include clauses which withdraw possible differences of controversies from the national jurisdiction of the recipient country, or which permit subrogation by the governments of the shares or rights of their national investors.” *Standard Regime for Treatment of Foreign Capitals [sic] and for Treatment of Marks, Patents, Licenses and Royalties*, Andean Comm’n Dec. 24, art. 51 (1970), *reprinted* in 10 INT’L LEGAL MAT’LS 152, 166 (1971) (unofficial translation).

clause in economic development agreements.<sup>86</sup> This tendency is generated by the determination of those countries to reject any express or implied suggestion that their legal systems are inferior to any other. When foreign investors enter into investment agreements with the governments of developed countries, it is assumed that the legal systems of the developed countries govern the agreement.<sup>87</sup> Why, the developing countries argue, should it be any different with agreements with them?

The methods by which these countries try to exclude the possibility of a choice of law in contracts with foreign investors consist of either requiring a national organization of the foreign business enterprise (for example, partnerships or corporations) or stating expressly that the national legal order will govern all disputes. The practice of the Federal Republic of Nigeria, in granting oil exploration and prospecting licenses and mining leases, illustrates both methods. The earlier oil licenses and leases provided for arbitration of disputes (except over those matters expressly excluded or said to be at the discretion of the Minister or Commissioner) and stated that the lease or license "shall be governed and construed in accordance with the laws of Nigeria and Nigerian law shall be the proper law hereof."<sup>88</sup> Since 1968, all foreign enterprises, whether established in Nigeria before or after 1968, are required to be incorporated under Nigerian law.<sup>89</sup> This requirement makes all foreign enterprises, in Nigeria, Nigerian nationals subject of course to Nigerian laws. The Nigerian Petroleum Decree, 1969, which regulates the oil industry, vests in Nigeria ownership and control of all petroleum and provides that licenses or leases to explore, prospect, and mine petroleum "may be granted only to—(a) a citizen of Nigeria, or (b) a company incorporated in Nigeria under the Companies Decree 1968 or any corresponding law."<sup>90</sup> Since only Nigerians can engage in the petroleum industry, it follows that there can be no possibility

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86. For the practices of the Black African countries, see Lipton, *supra* note 81. See also Smith & Wells, *supra* note 47.

87. OECD, THE EXPLORATION FOR AND EXPLOITATION OF CRUDE OIL AND NATURAL GAS IN THE OECD AREA INCLUDING THE CONTINENTAL SHELF; MINING AND FISCAL LEGISLATION 16 (1973).

88. Article 60 of the Standard Mining Lease.

89. Companies Decree, No. 51, of 1968, S. 369. See generally M. ADESANYA & E. OLOYEDE, BUSINESS LAW IN NIGERIA 227-48 (1972). For examples from other countries, see The Status of Permanent Sovereignty over Natural Wealth and Resources, U.N. Doc. A/AC.97/5 Rev. 2 [E/3511] (1959); Report of the Commission on Permanent Sovereignty over Natural Resources, U.N. Doc. A/AC.97/13 (1959).

90. Petroleum Decree of 1969, Ss. 2(2)(a)-2(2)(b).

for a choice of law clause in oil agreements. Moreover, Schedule I to the Decree, which deals with the nature and form of licenses and leases, provides in article 41 that any disputes shall be settled by arbitration unless such disputes are expressly excluded or stated to be at the discretion of the Commissioner. The Decree then provides that all such arbitrable disputes "shall be settled in accordance with the law relating to arbitration in the appropriate state and the provision shall be treated as a submission to arbitration for purposes of that law."<sup>91</sup>

The insistence of the developing countries on the application of their own laws to agreements with foreign investors has been largely motivated by the directives of the many natural resources producer organizations. For example, the OPEC guidelines for petroleum policy in member countries direct that:

Except as otherwise provided for in the legal system of a Member Country, all disputes arising between the Government and operators shall fall exclusively within the jurisdiction of the competent national courts or the specialized regional courts, as and when established.<sup>92</sup>

Another example is Decision 24 of the Andean Commission,<sup>93</sup> made December 31, 1970, according to which foreign investment agreements by member countries shall not include clauses which "withdraw possible differences or controversies from the national jurisdiction of the recipient country."<sup>94</sup> Since 1966, the several United Nations resolutions on permanent sovereignty of states over their natural resources, emphasizing the exclusive jurisdiction of local law, have also been influential in encouraging the developing countries to insist that all their agreements with private foreign investors be governed by local law.

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91. *Id.* S. 10(1).

92. OPEC Res. XVI. 90, *supra* note 43, reprinted in 7 INT'L LEGAL MAT'LS 1186 (1968).

93. Andean Comm'n Dec. 24, *supra* note 85, reprinted in 10 INT'L LEGAL MAT'LS 152 (1971). The Commission was established by the Agreement on Andean Subregional Integration [Cartagena Agreement], May 26, 1969, ch. II, § A, arts. 6-12, reprinted in 8 INT'L LEGAL MAT'LS 910, 911-13 (1969). See generally Abbott, *Bargaining Power and Strategy in the Foreign Investment Process: A Current Andean Code Analysis*, 3 SYR. J. INT'L L. & COM. 319 (1975).

94. Andean Comm'n Dec. 24, *supra* note 85, art. 51, reprinted in 8 INT'L LEGAL MAT'LS at 166.



## 2. PROVISIONS DIRECTING THE APPLICATION OF LAW COMMON TO THE CONTRACTING STATE AND THE STATE OF THE FOREIGN INVESTOR

As has already been indicated, one of the reasons for the suggestion that economic development agreements with foreign investors should be governed by some law other than the law of either the contracting state or the state of the foreign investor is that the parties do not know or understand the laws of one another's jurisdiction. As a technique of achieving equanimity between the parties, a provision directing the application of rules and principles of law common to all the parties, and requiring the filling of any gaps with principles of international law including the general principles of law referred to in article 38(1)(c) of the Statute of the International Court of Justice, has been adopted in some agreements.

A good illustration of this kind of provision is to be found in article 46 of the 1954 Consortium Agreement between Iran and a group of foreign companies. This Agreement provides, in part:

*In view of the diverse nationalities of the parties to this Agreement it shall be governed by and interpreted and applied in accordance with the principles of law common to Iran and the several nations in which the other parties to this Agreement are incorporated, and in the absence of such common principles then by and in accordance with principles . . . as may have been applied by international tribunals.*<sup>95</sup>

There are variations of this kind of formulation of the applicable law. Their design is said to be to strengthen confidence and a sense of security in the foreign investor by assuring him that disputes arising from the operation of the contract will be resolved by application of reasonable rules. The actual formulation will depend on the condition of the parties and the strength of their desire to do business with one another, whether such desire was generated by enthusiasm or hardship.<sup>96</sup>

Some have argued that provisions such as these are indicative

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95. Consortium Agreement (Iran-NIOC) of 1954, art. 46, *quoted in Sapphire Int'l Petroleums, Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136, 174 (1967); McNair, *supra* note 1, at 8-9 (emphasis added). See generally Farmanfarma, *The Oil Agreement Between Iran and the International Oil Consortium: The Law Controlling*, 34 TEX. L. REV. 259, 269-74 (1956).

96. In the *Sapphire Int'l Petroleums* arbitration, it was suggested that the wording of article 46 of the 1954 Consortium Agreement between Iran and the Companies was discussed extensively, and that the agreement on the form was influenced by the difficulties being experienced by the Iranian Treasury. Oil production had stopped because of the dispute arising from the expropriation law of 1951, and Iran felt the need to "put an end to a situation which was likely to become rapidly worse." 35 I.L.R. at 174.

of the parties' intention to apply international law to the exclusion of the law of the grantor state.<sup>97</sup> This would not appear to be the case from a careful reading of the provision. International law, which must be said to include not only the rules and principles of interstate law but also worldwide practices in the particular industry, is not utilized until it has become evident that the law of the grantor state is inadequate to settle the controversy in question. The intention to exclude the legal order of the grantor state cannot be read into such a provision. To do so would defeat the genuine function which the permissible resort to the principles of international law is designed to perform, namely, to provide rules in aid of fair interpretation of the agreement and, in the case of adverse state action involving a breach of international obligation, to provide the standards for evaluating the state action. Resort to international law, therefore, is only to supplement local law in the resolution of the dispute.

This seems to be the principle behind the provision for applicable law in the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. Article 42 of this Convention provides that:

- (1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.<sup>98</sup>

A fair interpretation of this provision would include the view that it requires, in the absence of express provision otherwise, that primary resort be to local law of the contracting state, and secondary resort be to rules of international law, if such rules aid interpretation and application of the agreement. International law, therefore, is to complement the local law and not to supplant it.

### 3. PROVISIONS DIRECTING THE APPLICATION OF THE CONTRACTING STATES' LAW TO ONE ASPECT OF THE AGREEMENT AND INTERNATIONAL LAW TO OTHERS

As in the case just considered, in order to accommodate each

97. See McNair, *supra* note 1, at 3-4; Kissam & Leach, *supra* note 2, at 198; Ray, *supra* note 2, at 10; Broches, *supra* note 69.

98. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, March 18, 1965, art. 42(1), 17 U.S.T. 1286, T.I.A.S. No. 6090, 575 U.N.T.S. 159.

other, the parties may include choice of law clauses in their agreement whereby the subject matter of disputes is divided into two or more aspects, each to be governed by a different legal order. A classic example of this form is provided by an arbitration agreement between the government of Saudi Arabia and the Arabian American Oil Company (ARAMCO) in 1955. Article IV of that agreement provides:

The Arbitration Tribunal shall decide this dispute

(a) in accordance with Saudi Arabian law, as hereinafter defined, in so far as matters within the jurisdiction of Saudi Arabia are concerned;

(b) in accordance with the law deemed by the arbitration tribunal to be applicable in so far as matters beyond the jurisdiction of Saudi Arabia are concerned.<sup>99</sup>

The reference to Saudi Arabian law was to the Moslem law as taught by the school of Imam Ahmed ibn Hanbal and as applied in Saudi Arabia.

This provision received extensive consideration by the tribunal set up under the arbitration agreement. In order to understand the effect which the tribunal gave to the provision, it will be necessary to give some background of the dispute which led to the 1955 agreement.

Saudi Arabia, in 1933, entered into a concession agreement with ARAMCO<sup>100</sup> by which ARAMCO was granted, *inter alia*, "the exclusive right, for a period of 60 years . . . to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum, asphalt, naphtha, natural greases, ozokerite and other hydrocarbons, and the derivatives of all such products."<sup>101</sup> In 1954, Saudi Arabia entered into a contract with Aristotle Onassis, by which Onassis was given permission to form a private company, Saudi Arabian Maritime Tankers Company Ltd. (SATCO), which was granted the "right of priority for the transport of oil" from Saudi Arabian ports to foreign markets.<sup>102</sup> The government then required ARAMCO to give SATCO priority for transport-

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99. Saudi Arabia v. Arabian Am. Oil Co. (ARAMCO), 27 I.L.R. 117, 231 (1958). For the entire text of the Arbitration Agreement, see *id.* at 229-33.

100. The original agreement was with the Standard Oil Company of California, which assigned it to the California Arabian Standard Oil Company. The latter changed its name to the Arabian American Oil Company, or ARAMCO. *Id.* at 117-18.

101. *Id.* at 175.

102. *Id.* at 127-28.

ing Saudi Arabian petroleum to foreign countries. ARAMCO claimed that the Onassis agreement was inconsistent with the rights granted to it under the 1933 concession agreement. A difference of opinion therefore arose between the parties, and it was to resolve this difference that the arbitration agreement was concluded.

The arbitration agreement made clear that the government was not attempting to exercise any sovereign rights in derogation of the 1933 concession agreement.<sup>103</sup> In the view of the parties, the only issue was the interpretation of the 1933 concession agreement and the determination of the consistency of the Onassis agreement with the rights granted to ARAMCO under the concession agreement. The tribunal, therefore, was simply to make a declaration of the rights of the parties.

The tribunal's first task was to delineate matters which fell within the jurisdiction of Saudi Arabia and, therefore, to be regulated by Saudi Arabian law, and those which fell outside that jurisdiction. In the case of the latter, the tribunal was directed by article IV(b) of the agreement to apply the law it deemed applicable. In determining matters within the jurisdiction of Saudi Arabia, the tribunal first noted that a contract or concession agreement cannot exist in a vacuum. The tribunal stated:

It is obvious that no contract can exist *in vacuo*, *i.e.*, without being based on a legal system. The conclusion of a contract is not left to the unfettered discretion of the Parties. It is necessarily related to some positive law which gives legal effects to the reciprocal and the concordant manifestations of intent made by the parties. The contract cannot even be conceived without a system of law under which it is created. Human will can only create a contractual relationship if the applicable system of law has first recognized its power to do so.<sup>104</sup>

The tribunal then stated its belief that the appropriate governing law of a concession agreement should coincide with the economic

103. The sixth "Whereas" clause of the arbitration agreement stated:

WHEREAS the Government and Aramco state that (1) they respect all obligations which they have undertaken and now undertake, (2) the Government and Aramco have never entertained the thought that they would not be bound by the agreements they have made and now make with one another, and (3) agree that neither the agreement on the part of the Government and Aramco to arbitrate the dispute herein pursuant to Article 31 of the Aramco Concession Agreement nor the arbitration itself includes or involves the right of sovereignty of the Government

*Id.* at 230. *See id.* at 149-53.

104. *Id.* at 165 (footnote omitted).

milieu in which the operation is to be carried out, that is, the law of the country with which the agreement "has the closest natural and effective connection."<sup>105</sup> It stated that the selection of this legal order is to be guided by principles of private international law according to which the express choice of the parties must be given paramount consideration. Failing such expression of the will, the tribunal was to be guided by general principles of private international law.

The tribunal then concluded that matters within the purview of the agreement had the closest natural and effective connection with Saudi Arabia, pointing out that the concession agreement itself, its operation, and its interpretation belonged to the jurisdiction of Saudi Arabia: the agreement was signed in Jeddah, Saudi Arabia; it was for the most part to be performed in Saudi Arabia; "its performance entail[ed] the exploitation . . . of the hidden wealth of the subsoil of Saudi Arabia and the creation of proprietary rights in immovables situated in the territory of that State."<sup>106</sup> Further, Saudi Arabia, the grantor, was a sovereign state and was presumed to have subjected its contracts with private individuals to its own legal order.<sup>107</sup> For these reasons, the tribunal found that the Saudi Arabian legal order was the basic governing law of the concession agreement.<sup>108</sup>

The question of the inadequacy of Saudi Arabian law to regulate a complex concession agreement was then raised by ARAMCO. It argued that because the Hanbali school of Moslem law, the law of Saudi Arabia, was not sufficiently developed to regulate petroleum exploitation operations, the concession agreement "must be 'delocalized' and assimilated to an international treaty, governed by the Law of Nations," including the general principles of law recognized by civilized states.<sup>109</sup> The tribunal had no difficulty in dismissing this argument, noting that "Saudi Arabia belongs to one of the great legal systems of the world"<sup>110</sup> and shares with other major

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105. *Id.* at 167.

106. *Id.* at 166-67.

107. *Id.* at 167.

108. *Id.*

109. *Id.* at 162.

110. *Id.* The tribunal explained that Moslem Law has many schools or rites which are fundamentally the same, but which diverge with respect to certain details. "The principle Sunni Schools are the Hanafi, the Maliki, the Shaffei and the Hanbali . . . . The Hanbali School [which] is followed [in] Saudi Arabia . . . is the school of Imam Ahmed ibn Hanbal. Its fundamental principles were developed mainly by the jurist Ibn Taimiya." The Hanbali law, like the others, "is dominated by the principles of the Koran and of the 'Sunna' (*i.e.*,



systems of law fundamental principles of the law of contract, namely, the principle of liberty of contract and the principle of respect for contract.<sup>111</sup> With regard to the interpretation of the concession agreement, the tribunal noted that Moslem law has rules and principles of interpretation generally recognized by other major systems of law.<sup>112</sup> The tribunal took the view, however, that Saudi Arabian law alone could not govern the interpretation of the agreement in this case for two reasons. The first reason was that "[i]nterpretation of contracts is not governed by rigid rules; it is rather an art, governed by principles of logic and common sense, which purports to lead to an adaptation, as reasonable as possible of the provisions of [the] contract to the facts of a dispute."<sup>113</sup> The second reason was that, because of the complexities of the concession agreement and the lack of much experience in oil operations, Saudi Arabian law, which was the proper law, "must, in case of need, be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notions of pure jurisprudence."<sup>114</sup> This was the case, especially, "whenever certain private rights—which must inevitably be recognized to the concessionaire if the Concession is not to be deprived of its substance—would not be secured in an unquestionable manner by the law in force in Saudi Arabia."<sup>115</sup>

This is clearly in accordance with a basic policy that the legal order of the grantor state, when it is the proper governing law, cannot be displaced because it lacks the sophistication or refinements of other systems more familiar to the investor. It is clear that

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the tradition of the Prophet Mohamed), which are of Divine Revelation and which constitute the Shari'ah." The legal principles in these sources "have been developed by the science of 'Fikh' (jurisprudence), which might be called a kind of Moslem common law. The interpretation of the jurisprudence ('Fikh') is given by the Ulemas or doctors in theological and legal matters." *Id.* at 162-63 (citations omitted).

111. The tribunal elaborated these principles:

The first principle is stated by Ibn Taimiya as follows: "The following rule shall be obeyed: men shall be permitted to make all the transactions they need, unless these transactions are forbidden by the Book or by the Sunna." The second basic rule, in Ibn Taimiya's opinion, results from the fact that Moslem law does not distinguish between a treaty, a contract of public or administrative law and a contract of civil or commercial law. All [such] pacts must be observed, since God is a witness to any contract . . . [A]s expressed in the Koran: "Be faithful to your pledge to God, when you enter into a pact."

*Id.* at 163-64 (citations omitted).

112. *Id.* at 173.

113. *Id.* at 172.

114. *Id.* at 169.

115. *Id.*

the parties to an economic development agreement envisage such enrichment of the legal system of the grantor state by general principles of law and widely recognized international practices and usages. The tribunal, in fact, recognized that the parties in this case did exactly that.<sup>116</sup>

The opinion of the tribunal as a whole is not a paragon of clarity, but it is clear on the important question of the proper law of a concession agreement, namely, the law of the grantor state, supplemented as the need arises with world-wide customs and practices of the particular natural resource industry. Any other view of the form of the provision under consideration is untenable.

#### 4. PROVISIONS FOR THE APPLICATION OF INTERNATIONAL LAW

I treat here only those instances where the parties to a natural resource development agreement have expressly provided that international law should govern their relationship. I leave for later consideration cases where vague terms in the agreement have been interpreted as implying an intention of the parties to submit the agreement to international law.

An example of the case under consideration is provided by a concession agreement in 1933 between the Imperial Government of Persia and the Anglo-Persian Oil Company.<sup>117</sup> Article 22 of the agreement provided for arbitration of any dispute between the parties and stated that "[t]he award shall be based on the juridical principles contained in Article 38 of the Statutes [sic] of the Permanent Court of International Justice."<sup>118</sup> There seems to be no practical or doctrinal reason why a state cannot subject its contract with individuals to be governed by international law. Notwithstanding the general principle that a contract between a state and private individuals is not usually governed by international law, a state may

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116. Article 35 of the 1933 Concession Agreement which provided:

Inasmuch as most of the obligations hereunder are imposed upon the Company and inasmuch as the interpretation of the English text, especially as regards technical obligations and requirements relating to the oil industry, has been fairly well established through long practice and experience in contracts such as the present one, it is agreed that while both texts shall have equal validity, nevertheless in case of any divergence of interpretation as to the Company's obligations hereunder, the English text shall prevail.

*Id.* at 170. The Tribunal concluded that the parties unequivocally recognized "established custom and practice of the oil industry" and that "such custom and practice can therefore supplement an incomplete legal system." *Id.* at 170.

117. Quoted in McNair, *supra* note 1, at 7-8.

118. *Id.* at 8 (emphasis added).

expressly submit its contractual relations with private individuals, or for that matter with other states, to international law.<sup>119</sup> It is the prerogative of every state to treat private entities, insofar as their relation to the state is concerned, as subjects of international law for all or for particular purposes. As has been observed by a reputable scholar, "[i]n relation to itself, each subject of international law is free to recognize any other entity as a subject of international law" for any purpose.<sup>120</sup>

It should be observed, however, that even in such cases a tribunal, in applying international law, is not necessarily precluded from considering the law of the contracting state where relevant. Even in purely interstate disputes, relevant principles of domestic law have been applied by international tribunals. For example, in the *Norwegian Shipowners' Case*,<sup>121</sup> the compromis between the United States and Norway directed the tribunal to apply "principles of law and equity." The tribunal rejected the contention of Norway that United States law was precluded. It declared that it could not ignore the local laws of the parties, except that in applying such law, any special rules, for example, those limiting the rights of individuals against the government, cannot bind it. The point I make here, then, is that even in cases where international law is expressly made the law of the development agreement, the national law of the grantor state may not be entirely excluded.

Sometimes international law has been imported into agreements between states and foreign private investors by treaty, especially treaties for the promotion and protection of foreign investments. A recent technique is to incorporate within a treaty a provision for referring disputes arising between a state and national investors to the International Centre for Settlement of Investment Disputes. Under the recent *Agreement For the Promotion and Protection of Investments* between Singapore and the United Kingdom<sup>122</sup> covering, among other types of investment, "business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources," each party consents to submit to the Centre "any legal dispute arising

119. See generally Mann, *supra* note 71.

120. 1 G. SCHWARZENBERGER, *INTERNATIONAL LAW* 146 (3d ed. 1957).

121. *Norwegian Shipowners' Claims* (Norway v. United States) 1 R. Int'l Arb. Awards 307, 17 AM. J. INT'L L. 362 (Perm. Ct. Arb. 1922).

122. Done July 22, 1975, reprinted in 15 INT'L LEGAL MAT'LS 591 (1976); accord, *Agreement for the Promotion and Protection of Private Investments*, done June 11, 1975, Egypt-United Kingdom, reprinted in 14 INT'L LEGAL MAT'LS 1470 (1975).

between that Contracting Party and a national or company of the other Contracting Party concerning an investment of the latter in the territory of the former."<sup>123</sup> Each party has the right to institute arbitration proceedings in the Centre if "such dispute should arise and agreement cannot be reached . . . between the parties to [the] dispute through pursuit of local remedies or otherwise, [and] if the national or company affected also consents in writing to submit the dispute to the Centre for settlement by arbitration under the Convention . . . ."<sup>124</sup>

Although the Convention does not envisage arbitration between states, the effect of instituting arbitration proceedings by a state party under this treaty is to turn the arbitration into one between states, and because states are now involved, application by the tribunal of international law to the solution of the dispute becomes inevitable.

Generally, in cases where the agreement expressly indicates the applicable law, the only problem should be the interpretation of what the parties have actually said. When, by a fair interpretation of the contractual provision, the intention of the parties is discovered, it must be given the fullest recognition.

### *B. Assertions Made Where the Agreement Contains No Clear Provision for the Applicable Law*

The determination of the applicable law is most controversial where the agreement contains no clear provision for the choice of law. Various assertions or claims are then made about the applicable law. These assertions or claims are based mostly on the implications of vague words appearing in the agreements and on the nature of the development agreements themselves.

#### 1. IMPLICATIONS FROM EXPRESS WORDS IN THE AGREEMENT

Many economic development agreements state that the rights and the obligations of the parties are based on good faith and good will and contain no other provision for the applicable law. For example, article 38 of a recent agreement between Sapphire International Petroleum Ltd. and the National Iranian Oil Company<sup>125</sup> (NIOC)

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123. Singapore-United Kingdom, art. 8, reprinted in 15 INT'L LEGAL MAT'LS at 592.

124. *Id.*

125. Quoted in *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136, 140 (1963).

(an Iranian government corporation), provided that the parties undertook "to carry out the provisions of the contract in accordance with principles of good faith and good will and to respect the spirit as well as the letter of the agreement."<sup>126</sup> It also contained provisions for arbitration and specified the procedure for the appointment of the arbitrators. It fixed the location of the arbitration in Switzerland. A dispute arose between the parties, and an arbitral tribunal was set up in accordance with the agreement.<sup>127</sup> The tribunal, a sole arbitrator, considered the effect of article 38 and concluded that the provision for "good faith" and "good will" as well as for arbitration, was "scarcely compatible with the strict application of the internal law of a particular country" and that "[i]t much more often calls for the application of general principles of law based upon reason and upon the common practice of civilized countries."<sup>128</sup> The tribunal rejected any contention that Iranian law governed, observing that before and after the agreement with Sapphire International Petroleum Ltd. Iran had concluded other agreements<sup>129</sup> in which the application of international law and general principles of law recognized by civilized states was expressly provided. It concluded that the principles of good faith required that Iran could not rely on the "absence of an express provision regarding the law applicable" in the Sapphire agreement to deny a principle which it had accepted "in previous agreements which had the same object."<sup>130</sup>

The arbitrator cited and relied on arbitral precedents in which similar phrases appeared in the concession agreements. In the first such arbitration, *Lena Goldfields v. Soviet Union*,<sup>131</sup> the arbitrator interpreted "good will" and "good faith" as requiring the application of general principles of international law, not merely the application of the laws of the Soviet Union, to aspects of the agreement

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126. *Id.*

127. The National Iranian Oil Company (NIOC) refused to appoint its own arbitrator. The sole arbitrator was then appointed by the President of the Swiss Federal Tribunal, in accordance with article 41 of the agreement. *Id.* at 140-41. The NIOC then refused to participate in the arbitration. *Id.* at 161-62.

128. *Id.* at 173.

129. *Id.* at 174-75. The Tribunal referred to the Consortium Agreement of 1954, between Iran and the National Iranian Oil Consortium, and agreements concluded by Iran with other companies under the Iranian Petroleum Act of July 31, 1957.

130. *Id.* at 175; art. 14 of the Petroleum Act provides for conciliation and arbitration as the applicable dispute settlement mechanisms and leaves the details to be negotiated in particular concession agreements.

131. *The Times* (London), Sept. 3, 1930, at 7, col. 1; see Nussbaum, *The Arbitration Between the Lena Goldfields, Ltd. and the Soviet Government*, 36 CORNELL L.Q. 31 (1951).



in question. The second arbitral precedent relied on by the arbitrator concerned a dispute between Sheik Shakhbut of Abu Dhabi and Petroleum Development (Trucial Coast) Ltd.<sup>132</sup> There, Lord Ashquit of Bishopstone, the sole arbitrator, stated that the terms "good will" and "good intentions" repel the notion that the law of any particular country, as such, could be appropriate.<sup>133</sup> These terms, in his view, invited, and indeed mandated, the application of principles rooted in good sense and in the practice of civilized nations, a sort of "modern law of nature."<sup>134</sup>

In reaching these conclusions, the arbitral tribunals were undoubtedly, to use Lord McNair's phrase, "groping after some legal system which is not the territorial law of either party."<sup>135</sup> It is also clear that they were giving a meaning to the terms used by the parties in their agreement—a contextual meaning, one would assume. There can be no doubt that such a phrase, in a contract governed by English or American law, would not import the application of international law to the contract.

The appearance in concession agreements of phrases such as have been described here raises many questions: Why are they included? By using the phrases, do the parties intend a reference to the applicable law, or are they simply reassuring one another? Lord McNair offered the suggestion that the parties are groping for some law. This is a plausible explanation, no doubt, but given the desire of the foreign companies to escape the consequences of local laws of developing countries, why, if the intention was to subject the agreement to international law or to the general principles of law recognized by civilized states, do the agreements not expressly so state? It may be suggested that the tribunals were attempting to impose on the parties a legal system with which they were more familiar. It is not without consequence that these tribunals consisted of Western scholars or lawyers<sup>136</sup> who, if they were to accept the law of the countries involved in those arbitrations as the proper law of the agreements, would be less qualified to apply it. It is interesting that

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132. *Petroleum Dev. [Trucial Coast] Ltd. v. Sheikh of Abu Dhabi*, 18 I.L.R. 144 (1951), 1 INT'L & COMP. L.Q. 247 (1952). See also *Petroleum Dev. [Qatar] Ltd. v. Ruler of Qatar*, 18 I.L.R. 161 (1950).

133. 18 I.L.R. at 148-49.

134. *Id.* at 149.

135. McNair, *supra* note 1, at 10.

136. See Lord Asquith of Bishopstone (*Abu Dhabi Arbitration*); the Right Hon. Sir Alfred Bucknill (*Arbitration between Ruler of Qatar and Int'l Marine Oil Co., Ltd.*); Dr. Stutzer and Sir Leslie Scott (*Lena Goldfields Arbitration*).

the ARAMCO arbitration,<sup>137</sup> which included Moslem lawyers,<sup>138</sup> found, contrary to opinions expressed in these earlier cases, that Moslem law was one of the major legal systems of the world and was capable of regulating modern concession agreements.<sup>139</sup>

It has not been possible to determine at whose initiative such terms were included in those concession agreements. It would not be surprising if they were found to have been included at the instance of the local authorities. After all, the agreements were concluded when there might have been, to quote Lord McNair again, “‘too great might on the one side, and unmight on the other’, or too great commercial experience on the one side and lack of it on the other . . . .”<sup>140</sup> At that time, there could be no doubt about the commercial inexperience of the sheiks in the petroleum industry. They may therefore have been seeking to ensure that the companies, which alone controlled all the information used to calculate benefits accruing to them, would be fair and honest. If this view is plausible, then it is reasonable to suggest that the provision for good faith and good will could not refer to the applicable law.

If this view is wrong and the terms are deemed to refer to the applicable law, another question is raised: Why could “good will” and “good faith” not operate within the local law? In fact, the decision in *Lena Goldfields*<sup>141</sup> has been appropriately criticized for this reason by Arthur Nussbaum, who took the view, contrary to the tribunal’s, that Soviet law governed the agreement in that case in all respects, and that, in effect, the provision for “good will and good faith, as well as reasonable interpretation” was at best a hope that Soviet law would do justice between the parties.<sup>142</sup>

Notwithstanding these opinions, a more reasonable inference from such provisions, and one which takes relevant facts and policies into account, is that the parties regard the legal order of the grantor state as the basic law of the agreement. This inference is also consistent with respect to principles of international law or universal customs and usages when these aid the reasonable interpretation of the agreement. The impact of a natural resource agree-

137. *Saudi Arabia v. Arabian Am. Oil Co. (ARAMCO)*, 27 I.L.R. 117 (1958).

138. The original arbitration tribunal consisted of arbitrators Habachy and Badawi. Dr. Badawi died during the proceedings and was succeeded by H.E. Mahmoud Hassan. 27 I.L.R. at 117.

139. *Id.* at 162.

140. McNair, *supra* note 1, at 2.

141. *The Times* (London), Sept. 3, 1930, at 7, col. 1.

142. Nussbaum, *supra* note 131, at 36, 40.

ment upon the social and legal orders of the grantor state is so pervasive that any other inference is not permissible. The presumption in favor of a grantor state's legal order as the creator of property rights in the natural resources of the state is very strong and must not be so easily displaced. To quote an Iranian court of first instance which rejected the conclusions reached by the arbitrator in *Sapphire International Petroleum Ltd.*,<sup>143</sup> "[t]he material and spiritual relations which link [the concession agreement] to the laws and the judicial system" of the grantor state support and confirm its continuing and constant control.<sup>144</sup>

## 2. ASSERTIONS BASED ON THE NATURE OF ECONOMIC DEVELOPMENT AGREEMENTS

The debate about the law of economic development agreements under this heading can be conveniently divided into three schools of thought: (1) the internationalists, (2) the sub-internationalists, and (3) the localists. Each of these schools justifies its position by pointing to one or more characteristics of economic development agreements. There is little disagreement about the factual description of the essential elements of such agreements. As summarized by Lord McNair, they always involve a relationship, usually contractual, between a sovereign state and private entities; they relate to natural resources over which the state exercises right of ownership; they call for the expenditures of large sums of money by the private party; their subject matter constitutes important raw materials indispensable to global development, and their conclusion, most of the time, involves the exercise of the government's public authority. All sides to the debate appeal to these and other factors to justify their positions.

### a. *The Internationalists*

The "internationalists" consist of scholars and some arbitrators who assert that economic development agreements between a grantor state and a foreign investor should be governed by international law. They begin by asserting that such agreements possess an international or quasi-international character.<sup>145</sup> They list numerous fac-

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143. Iranian Court Decision on Arbitral Award in Dispute Between *Sapphire Int'l Petroleum Ltd.* and the National Iranian Oil Co., *judgment of Dec. 1, 1963*, Court of First Instance, Teheran, reprinted in 9 INT'L LEGAL MAT'LS 1118, 1123 (1970).

144. *Id.*

145. See Carlston, *International Role of Concession Agreements*, 52 NW. L. REV. 618

tors relating to such contracts which, they believe, make this characterization inevitable. The following factors are selective.

It is said that these agreements confer unusual rights of a semi-political character, such as complete freedom to export and import, and are usually of long duration. The agreements may at times confer immunity from taxation. From inception, they may engage the diplomatic or "good offices" intervention of the state of the concessionaire.

The agreements generate movement of materials and personnel to and from the grantor state,<sup>146</sup> and constitute the means for exploiting and distributing mineral resources internationally. Their continued functioning constitutes a basic expectation of the world community.<sup>147</sup> In addition, since there is usually no domestic market for the products, the concession is actually international in character. The fact that one of the parties to the concession agreement is a state is further evidence in support of "internationalization." With regard to this point, Dr. Mann observed that if a party to a contract is an international person, particularly a state, there exists ipso facto a sufficient connection with supranational rules of law which, on any view of the proper law theory, may enable and justify the parties in delocalizing their contract and submitting it to what may be called public international law.<sup>148</sup> He added that such internationalization would make applicable the general treaty law or the general principles of law recognized by civilized nations, as provided for in article 38(1)(c) of the Statute of the Court.

The fact that the agreements often contain provisions for the possible appointment of the arbitrators by an international official has also been adduced as an argument supporting the view that such agreements are governed by international law. It is pointed out that many of the more modern agreements provide that if the parties fail to agree on the appointment of arbitrators, the President or the Vice-President of the International Court of Justice should perform that function.<sup>149</sup>

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(1958); Mann, *The Proper Law of Contracts Concluded by International Persons*, 35 BRIT. Y.B. INT'L L. 34 (1960); McNair, *supra* note 1, at 3-4; Schwebel, *supra* note 2, at 266; Verdross, *Protection of Private Property Under Quasi-International Agreements*, 6 NETH. INT'L L. REV. 355 (1959); *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136, 171 (1963).

146. See Ray, *supra* note 2, at 17.

147. See Huang, *Some International and Legal Aspects of the Suez Canal Question*, 51 AM. J. INT'L L. 277, 289-96 (1957).

148. Mann, *supra* note 145, at 44.

149. In the concession agreement concluded between the Anglo-Iranian Oil Co. and Iran,

These factors are admittedly important. They certainly impart international aspects to the relationship. But it is quite a different thing to conclude from these that the agreement has a character other than that of an institution of the public and private law of the grantor state. The function of an arbitrator appointed by the President of the International Court of Justice is designated "extrajudicial,"<sup>150</sup> and, therefore, has no legal significance apart from its relevance as a means of solving a deadlock. It is perhaps only a demonstration by the parties of their faith in the impartiality, prestige, and authority of the Court. It has been suggested that article 13(1) of the rules of the Court,<sup>151</sup> which disqualifies the President of the Court from presiding over a dispute between two states of one of which he is a national, ought not to apply to this extrajudicial function.<sup>152</sup> Moreover, the official of the Court so designated is not obliged to accept the function since parties make such arrangements without prior consultation with the Court. *Jully* noted that in at least one case involving a concession agreement, the President of the International Court of Justice rejected a party's request to appoint an umpire on the grounds that the power was conferred on the Permanent Court of International Justice and that there had been no request by the parties that the International Court of Justice should perform the function.<sup>153</sup> It cannot seriously be argued that, although the agreement in this case had an international character because an international official was designated to appoint an umpire, it lost that character because the Court failed or had no opportunity to make the appointment. Such a conclusion would be absurd.

It is to be observed that the parties themselves do not consider this function of the President of the Court as anything other than administrative. Any contrary view might subject some concession agreements to the laws of another system. The only connection with

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art. 22 provided for the settlement of disputes by arbitration, the umpire of which was to be appointed by the president of the I.C.J. if the arbitrators selected by the two parties could not agree. *The Anglo-Iranian Oil Co. Case*, I.C.J. Pleadings 268 (1952). See *Jully*, *infra* note 150, at 402-03.

150. *Jully*, *Arbitration and Judicial Settlement*, 48 AM. J. INT'L L. 380, 399 (1954).

151. I.C.J. RULES art. 13, para. 1 reads as follows: "If the President is a national of one of the parties to a case brought before the Court, he will abstain from exercising his function as President in respect of that case."

152. See *Jully*, *supra* note 150, at 400. *But see id.* at 406. *Jully* observed that if the art. 13, para. 1 limitation is not followed, legitimate awards may be repudiated because the arbitrator was appointed by a national of one of the parties to the dispute.

153. *Id.* at 403.



the agreement may be the fact that a public official of that system, under the clause of the agreement, has the function of appointing one of the arbitrators or an umpire. In agreements where the function is given to, but not exercised by, the President of the Swiss Cantonal Tribunal, the presidents of the supreme courts of Denmark, Sweden, or Brazil, in that order, exercise the function.<sup>154</sup> There can be no doubt, however, that the parties could not be deemed to have left the choice of law governing their agreement to such a gamble.

Another contention in favor of international law as the governing law is expedience. Judge Philip Jessup wrote that it is expedient to apply international law to concession agreements because it helps to overcome the problem of the unwillingness of the grantor state to submit to foreign law and the unwillingness of the alien individual or corporation to leave the adjudication of disputes to the courts of the grantor state.<sup>155</sup> Another scholar thinks that international law has advantages both procedurally and substantively, and is more easily drafted into the agreements than is the provision of a specific law.<sup>156</sup> Delaume stated that application of international law is the only alternative where the circumstances of a particular law "make it 'impossible to assume that the parties intended to be governed by a national system of law.'"<sup>157</sup>

Long ago, Dr. Mann made a strong case for the application of international law *stricto sensu* to economic development agreements. He stated that where the parties have not expressly or impliedly provided for a law to govern their contract, a presumption in favor of international law has the great utility of assuring that the existence of, and faith in, such contracts "would be immune from any encroachment by a system of municipal law in exactly the same manner as in the case of a treaty between two international persons . . . ."<sup>158</sup> He contemplated that the application of international law in this case would be undertaken by national or international officials, judges, or arbitrators having jurisdiction over the contract. The substantive law which they would apply would largely be de-

154. See *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136, 141 (1963).

155. P. JESSUP, *A MODERN LAW OF NATIONS* 141 (1959).

156. See Wadmond, *Arbitration Between Governments and Foreign Private Firms*, 1961 AM. SOC'Y INT'L L. PROC. 69, 73.

157. Delaume, *The Proper Law of Loans Concluded by International Persons: A Restatement and a Forecast*, 56 AM. J. INT'L L. 63, 78 (1962).

158. Mann, *supra* note 145, at 43.

rived from those principles of law "accepted *semper ubique et omnibus*," such as those which govern the interpretation of commercial treaties.<sup>159</sup>

In response to the objection of those who fear that "internationalization" of such contracts may make their performance impossible because public international law has not yet succeeded in developing the necessary legal rules,<sup>160</sup> Dr. Mann would reply that such an objection overlooks the fact that treaties between sovereign states may pertain to substantially the same subject matter as the contracts between a state and private individual, and that public international law has rules which are already developed or which are in the process of being developed.

What is objectionable about the internationalists' position is their apparent motive. The internationalists do not emphasize that international law should be used for a more reasonable interpretation of the agreement or for a better means of evaluating the compatibility of the contracting sovereign's regulatory powers with the minimum standards of international law governing the treatment of foreigners within its jurisdiction. Rather, the internationalists emphasize the need for such contracts in order to escape the comprehensive and continuing authority of the contracting state as an end in itself.<sup>161</sup>

The contention that international law should form the basis of economic development agreements has also been supported by assertions that such agreements, because of their international connections, are in reality international agreements. This issue was considered in 1950 by the International Court of Justice in the *Anglo-Iranian Case*.<sup>162</sup> This case involved a dispute which arose between Great Britain and Iran over the cancellation by Iran of a concession of the Anglo-Iranian Company (a British company). Iran contested the jurisdiction of the Court on the basis that the dispute was between Iran and the British company and was not within

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159. *Id.*

160. See Wolff, *Some Observations on the Autonomy of Contracting Parties in the Conflict of Laws*, 35 *GROTIUS SOC'Y* 143 (1950); Friedmann, *Some Impacts of Social Organization on International Law*, 50 *AM. J. INT'L L.* 475, 484 (1956).

161. *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, 35 *I.L.R.* 136 (1963). One reason given by the arbitrator for excluding the application of Iranian law in the *Sapphire* case was that the foreign company should be assured legal security. This could not be done since it is within Iran's power to change its laws. *Id.* at 171; see note 145 *supra*.

162. *Anglo-Iranian Oil Co. Case*, [1952] *I.C.J.* 92. See Fitzmaurice, *The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points*, 33 *BRIT. Y.B. INT'L L.* 203, 240 (1957).

Iran's declaration conferring jurisdiction on the Court under the optional clause of the Statute of the International Court of Justice.<sup>163</sup> The British government contended that the Court had jurisdiction because the concession agreement cancelled by Iran had a dual character: it was a concession to the company as well as a treaty between the United Kingdom and Iran.

In order to appreciate the argument of the United Kingdom, it is necessary to explain the historical background of the concession agreement. The Anglo-Iranian Company held a previous oil concession in Iran which was cancelled by Iran in 1932. The United Kingdom protested this action in vain, and finally submitted the matter to the Council of the League of Nations.<sup>164</sup> The dispute was then put on the agenda of the Council, and was later withdrawn when the Council was notified that the company, Iran, and the British government had agreed to forego the Council proceedings and to pursue a settlement. The negotiation which ensued resulted in the 1933 concession agreement between Iran and the company. The Council was duly informed of this. In presenting his report to the League of Nations, the Rapporteur declared that "the dispute between His Majesty's Government of the United Kingdom and the Imperial Government of Persia is now finally settled."<sup>165</sup>

In the *Anglo-Iranian Case*, the United Kingdom contended before the Court that the above proceedings constituted a "tacit" or "implied" agreement between it and Iran and must be considered to be within the meaning of the term "treaties or conventions" in the Iranian declaration. It further contended that the concession agreement of 1933 terminated the dispute between it and Iran and that for this reason the agreement was international in character.<sup>166</sup>

In rejecting this attempt by the United Kingdom to assimilate the concession agreement into a treaty through the back door or "indirection,"<sup>167</sup> the Court declared:

163. *Anglo-Iranian Oil Co. Case*, [1952] I.C.J. at 130-34.

164. See Hudson, *The Thirteenth Year of the World Court*, 46 AM. J. INT'L L. 1, 12-14 (1952).

165. *Id.* at 14.

166. The United Kingdom relied on the *Case of the Free Zones of Upper Savoy and the District of Gex*, [1932] P.C.I.J., ser. A/B, No. 46. The King of Sardinia, by means of a manifesto addressed to them, had directed the Sardinian customs, at the instance of the Canton of Valais, to withdraw the customs line which Sardinia was obliged to withdraw by a treaty manifesto. The manifesto was viewed by the Court as terminating an international dispute and thus acquired an international character. See H. LAUTERPACHT, *DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT* 211 (1957); see also *Anglo-Iranian Oil Co. Case*, [1952] I.C.J. 92, 113.

167. See Fitzmaurice, *supra* note 164.

The Court cannot accept the view that the contract signed between the Iranian Government and the Anglo-Persian Oil Company has a double character. It is nothing more than a concessionary contract between a government and a foreign corporation. The United Kingdom Government is not a party to the contract; there is no privity of contract between the Government of Iran and the Government of the United Kingdom. Under the contract the Iranian Government cannot claim from the United Kingdom Government any rights which it may claim from the Company, nor can it be called upon to perform towards the United Kingdom Government any obligations which it is bound to perform towards the Company. The document bearing the signatures of the representatives of the Iranian Government and the Company has a single purpose: the purpose of regulating the relations between that Government and the Company in regard to the concession. It does not regulate in any way the relations between the two Governments.<sup>168</sup>

The Court eventually decided that it had no jurisdiction by virtue of the Iranian declaration, which included treaties and conventions only. Although the Court was primarily concerned with jurisdiction, it clearly regarded the concession as a private contract subject to Iranian law. This view was supported by Sir Gerald Fitzmaurice<sup>169</sup> who pointed out that such an agreement, whether considered from the point of view of the government party concerned or of the private party, cannot in any technical sense be equated with a treaty or other kind of international agreement. He stated further, that although an international tribunal may find it necessary to consider and pronounce upon the terms of such agreements, they are basically contracts governed by the appropriate system of domestic law. Disputes concerning them fall within the competence of the local courts. If the disputes are referred to arbitration, the tribunal must rank as a private, and not an international, tribunal.<sup>170</sup>

Except in those cases where a concession agreement can be assimilated into a treaty, the only way it can reach the international level is through diplomatic espousal, by his home government, of the claim of the investor. As was explained by Sir Gerald Fitzmaurice, the international aspect of a concession is quite distinct from its domestic aspect. The domestic aspect concerns the relationship of the concessionaire, national or foreign, with the state. The inter-

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168. Anglo-Iranian Oil Co. Case, [1952] I.C.J. 92, 112.

169. See Fitzmaurice, *supra* note 164, at 246.

170. *Id.*

national aspect concerns the state's treatment of the foreign investor and raises questions pertaining to the relation between the state and the investor's state, and not to the relation between the state and the concessionaire.<sup>171</sup> It is to these relations or questions that international law properly applies.

In *The Mavrommatis Palestine Concessions* case,<sup>172</sup> the Attorney General of the United Kingdom, in the course of his argument on the jurisdiction of the Permanent Court of International Justice, took a different view of the legal status of concession agreements than the one maintained by the British government in the *Anglo-Iranian Case*. He pointed out to the Court that:

Few things can be worse for the dignity of the Court than that it should find itself involved in trying a multitude of cases which are, in fact, claims by private persons such as are dealt with in the ordinary municipal courts, but which are diverted to this tribunal because it happens that the respondent is a sovereign State and the claimant is a subject of some other Power.<sup>173</sup>

In his view *Mavrommatis Palestine Concessions* involved purely questions of domestic law and did not get to the international level merely because it concerned a state and an alien individual.

A case for applying international law to agreements under consideration can be built around the fact that many countries now subscribe to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States,<sup>174</sup> under which disputes arising from economic development agreements can be submitted to the International Centre for Settlement of Investment Disputes created under the Convention. The arbitral tribunal, under the auspices of the Centre, is certainly an international tribunal and, as such, traditionally applies international law. The agreement by states to submit investment disputes to the Centre may establish state practice from which customary international law can develop. However, the law to be applied by the tribunal is limited by the express choice of the parties.<sup>175</sup> It is true that the tribunal as an international tribunal may apply international law; however, a reasonable interpretation of its powers under article 42

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171. *Id.*

172. *The Mavrommatis Palestine Concessions*, [1924] P.C.I.J., ser. A, No. 2; see Hornsey, *Foreign Investment and International Law*, 3 INT'L L.Q. 552 (1950).

173. Hornsey, *supra* note 172, at 557.

174. March 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159.

175. See note 98 *supra* and accompanying text.



of the Convention would indicate that it can apply that law only to supplement gaps in the law of the state party.<sup>176</sup>

It can also be argued that certain U.N. resolutions, particularly resolution 1803 (XVII) dealing with permanent sovereignty over natural resources, provide evidence of the international character of natural resources development agreements.<sup>177</sup> As has been indicated earlier, resolution 1803 (XVII) implies that international law has equal status with national law in regulating those agreements.<sup>178</sup> However, quite apart from any prescriptive value which this resolution may have, the fact that all references to international law in subsequent U.N. resolutions on the subject were omitted is a clear indication that international law is no longer viewed as governing economic development agreements unless the parties have so expressly provided.

I cannot overemphasize my rejection of the internationalization of economic development agreements, which results in their being placed beyond the reach of the state's comprehensive responsibility to promote the safety, security, and well-being of its body politic. This comprehensive responsibility of the state creates a proper inference that, in construing concession agreements, whatever pertains to the sovereign right and duty of the state which is not expressly or by reasonable implication given away in favor of the concessionaire must be deemed to be reserved to the state. To hold otherwise would violate a basic principle of international as well as national law, that foreign persons and corporations operating by agreement within a state are subject to the laws and regulations of that state unless it is expressly agreed otherwise.

As has already been indicated, a state which is party to an economic development agreement can, by its own free will, subject its contract to international law. This may be achieved in a number of ways, for example, (1) where the agreement is embodied in or is the basis of an international agreement proper,<sup>179</sup> (2) where the concession agreement, which embodies the terms of a settlement, is annexed to a report made to an international organization and is deposited in the records of that organization, or (3) where the con-

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176. *Id.*

177. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR, Supp. (No. 17) 15, para. 3, U.N. Doc. A/5217 (1962).

178. See notes 28-40 *supra* and accompanying text.

179. See notes 122-24 *supra* and accompanying text.

179.1. McNair, *supra* note 1.

cession contracts contain express provisions that the instrument shall be governed by international law or general principles of law as a source of international law.

Where any of these is present, international community policy, giving deference to the sovereignty of states and the protection of agreements, would require that the expressed will of the parties be upheld.

#### *b. The Sub-Internationalists*

Under this heading, I group all those scholars and arbitral tribunals which take the position that economic development agreements not specifying the applicable law are not properly governed by either the legal order of the grantor state or international law *stricto sensu*. This group views such agreements as possessing certain unique features which place them outside the present dichotomy of municipal and international law.

Lord McNair first proposed this view in an address to the American Bar Association Convention in London (1958) and later, in the article referred to in this study.<sup>179,1</sup> The basis of his thesis is that this kind of agreement is entered into by a capital importing country with no developed legal system and a foreign corporation with capital to supply, and that by not specifying the law to be applied, the parties must be deemed to have intended that their contract should be governed by the general principles of law recognized by civilized nations. Such is not public international law *stricto sensu*, because that law is "*jus inter gentes*," but a third system of law which "shares with public international law a common source of recruitment and inspiration." It was stated that:

There is some evidence that [article 38(1)(c)] is likely to acquire another sphere of operation, namely, as affording in certain cases the choice of a legal system for the regulation of some of the new numerous contracts made between corporations . . . and the Governments of certain countries which have natural resources awaiting development but not enough capital or skill available for that purpose.<sup>180</sup>

Lord McNair's thesis was soon accepted by others. For example, another writer stated in reference to economic development agreements:

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180. *Id.* at 1.

We will find that there are two generally accepted principles—the *ad hoc* law of contract and *pacta sunt servanda*—which have survived for centuries, and which, when supplemented by general principles of law recognized by civilized nations, by jurisprudence generally and by applicable custom, will comprise a system of law both adequate and desirable as the system for which we are looking.<sup>181</sup>

Professor Verdross has declared that such concession agreements are “*quasi-public-international contracts*” which are not governed by municipal law or by public international law, but are submitted to the “*lex contractus* of the contract or concession.”<sup>182</sup> They constitute a third group of contracts which is characterized by the fact that the private rights which are thereby created are subjected to a new legal system established by the agreement of the parties. Such “*lex contractus*,” created by a quasi-public-international contract, regulates the relations between the parties.

The weakness of the position of this group arises from the nature of the general principles of law recognized by civilized nations. Both Lord McNair and Mr. Ray recognize that there is no catalogue of such general principles of law and that more and more of them will come to be expressed as they are required in specific cases.<sup>183</sup> It should be pointed out that certainty of legal rights and obligations in such contracts is of utmost importance. Agreements create legal rights and duties which cannot exist in a vacuum, but must exist in a legal system within which such questions as validity, application, and interpretation are confronted. It seems strange that this group would prefer to regard an uncertain *tertium quid* system of law as the most appropriate to fill this vacuum rather than to apply the municipal law of the grantor state which alone contains specific rules relating to natural resources. The certainty of obligations is not served when parties rest the determination of their rights and obligations on general principles of law recognized by civilized nations in the sense Lord McNair and others have used the concept.

Even with respect to general principles of law in the sense of article 38(1)(c) of the Statute of the International Court of Justice, there will be uncertainties about their recognition. For example, to which and how many legal systems must a particular principle be known? Answers to these questions would call for expertise in comparative law, which few arbitrators and judges have. This is the real

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181. Ray, *supra* note 2, at 11.

182. Verdross, *supra* note 145, at 358-59.

183. McNair, *supra* note 1, at 15; Ray, *supra* note 2, at 44.

danger of placing reliance on general principles of law recognized by civilized states. A scholar of comparative law has complained that a judge may apply his own law without reference to comparative systems.<sup>184</sup> This danger is well demonstrated in the *Abu Dhabi Arbitration Award*,<sup>185</sup> in which Lord Asquith, as the sole arbitrator, applied English law, even to the extent of quoting English decisions. It has been noted that:

If subsection (c) of Art. 38 is to have any real value in its application to international cases, recourse must be had to the advice and lessons to be obtained from comparative law, for only then will the generality of any particular legal principle be properly established, and once established its true interpretation propounded.<sup>186</sup>

The mere fact that a principle is to be found in several systems of private law does not, of course, vest it with the attribute of universality and entitle it to be translated into the international sphere. There may be, and often are, other factors to be taken into account, which may have the effect either of depriving the principle of its apparent universality or of rendering it unfit to function in the environment of international relations.<sup>187</sup>

Mr. Gutteridge, an acknowledged scholar of comparative law, once complained that the general principles were derived mainly from Western systems of law, and principally from continental Romanistic systems. He noted that the arbitral tribunals that have made decisions based on general principles of law were manned by jurists of this system and that they ignored other systems of law.<sup>188</sup>

Article 38(1)(c) can properly serve only as a residual source from which community decisionmakers fill any gaps in the international and municipal legal structure. General principles will come into existence as the outcome of experience gained over a long period in which international disputes are settled through arbitration. Frequent invocation and application of principles will place "the seal of international approval on a practice shown by such experience to

184. Discussion, *The Meaning and Scope of Article 38(1)(c) of the Statute of the International Court of Justice*, 38 GROTIVS Soc'y 125, 127 (1952) (statement by Mr. Gutteridge).

185. *Id.*

186. *Id.* at 127-28; see McDougall & Lasswell, *The Identification and Appraisal of Diverse Systems of Public Order*, in STUDIES IN WORLD PUBLIC ORDER 3 (1960).

187. See Discussion, *The Meaning and Scope of Article 38(1)(c) of the Statute of the International Court of Justice*, 38 GROTIVS Soc'y 125, 130 (1952) (statement by Mr. Cheng).

188. Gutteridge, *Comparative Law and the Law of Nations*, 21 BRIT. Y.B. INT'L L. 1, 2 (1944).

provide a suitable criterion of the requirements of justice."<sup>189</sup>

The rudimentary condition of comparative jurisprudence is the reason for the problem. In the light of today's standards, there appears to be no justification for the dominance of Western systems of law. If the dominance is maintained, it would only give a meaning to "principles recognized by civilized nations" which fails to describe the new situations that "have arisen since the age of Grotius when the law of Rome was the basic element in . . . the law of Europe and was universally regarded as the standard by which justice was measured."<sup>190</sup>

Whatever may have been the prospects of a catalogue of general principles emerging in concrete cases, as indicated by Lord McNair, the reality has been that "general principles of law recognized by civilized nations," based on Western legal systems or Western-dominated international law, have become a subject where international opinion is diverging instead of converging.<sup>191</sup> This phenomenon ought not to frighten us, for it is common with any institution in the process of change.<sup>192</sup> The consensus will emerge when the opinion of all mankind is polled and analyzed. It will emerge when the new order for which the developing countries are clamoring is taken into full account.<sup>193</sup> When this happens, there can emerge a

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189. *Id.* at 2.

190. *Id.* at 4; see also C.W. JENKS, *THE COMMON LAW OF MANKIND* 155 (1958).

191. See generally *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964). The Court said, with respect to limitations on a state's power to expropriate the property of aliens, [t]he disagreement as to relevant international law standards reflects an even more basic divergence between the national interests of capital importing and capital exporting nations and between the social ideologies of those countries that favor state control of a considerable portion of the means of production and those that adhere to a free enterprise system.

376 U.S. at 430.

With respect to the views of developing countries on the extent to which they are bound by rules of international law, including the general principles of law in the fashioning of which they did not participate, see Roy, *Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?*, 55 AM. J. INT'L L. 863 (1961). Jenks poses the question:

How far can we successfully invoke general principles of law recognised by civilised nations in a world in which the civil and common law must share their former supremacy with Islamic law, Hindu law, Chinese law and Soviet law? How helpful is judicial precedent, international and national, in this new perspective?

C.W. JENKS, *supra* note 190, at 91.

192. See Stone, *What Price Effectiveness?*, 1956 AM. SOC'Y INT'L L. PROC. 198, 203, where the author states: "it must remain a constant source of perplexity to distinguish departures from existing rules of international law which are merely outrageous breaches, from those which manifest inchoate legal change. But this is a perplexity with which, regrettably, we must learn to live."

193. See Declaration on the Establishment of a New International Economic Order, G.A.



system of general principles of law upon which parties to economic development agreements can base their rights and obligations.

*c. The Localists*

This school views economic development agreements as legal arrangements of a purely domestic character. The localists' position is based on theoretical and pragmatic considerations. As a starting point, the localists emphasize such general principles as: agreements concluded between a state and an individual cannot be governed by international law, and, a state is presumed to contract under its own law and cannot be deemed to have submitted to any other law without its express consent.<sup>194</sup>

According to the general practice of the majority of states, agreements dealing with land and other land-based natural resources are characterized as real property rights. This was emphasized by the *ARAMCO* arbitral tribunal, which stated "[w]hat is extracted from a mine or from a quarry is not a product of the soil; it is the soil itself which is being extracted; the 'exploitation' inevitably results in the exhaustion of the mine."<sup>195</sup> An investor who acquires such real property rights must do so under the laws and policies of the state concerned.

The importance of natural resources in the national policies of a developing country provides the most pragmatic and compelling reasons for subjecting to the legal order of the state all arrangements for resource development. The U.N. General Assembly resolutions and others to which I referred earlier emphasize this importance. Together they recognize that the right of every state to dispose of its natural resources is inalienable and that the creation and strengthening of that inalienable right reinforces the economic independence of the state.

On the very important question of the status of the agreements between foreign investors and the developing states, resolution 1803 (XVII),<sup>196</sup> which shares the acceptance of both capital exporting and

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Res. 3201, 6 Special Sess. U.N. GAOR, Supp. (No. 1) 3, U.N. Doc. A/9559 (1974); Programme of Action on the Establishment of a New International Economic Order, G.A. Res. 3202, *id.* at 5; Charter of Economic Rights and Duties of States, G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1974).

194. Case Concerning the Payment of Various Serbian Loans Issued in France, [1929] P.C.I.J., ser. A, No. 20, at 42; Case Concerning the Payment in Gold of the Brazilian Federal Loans Issued in France, [1929] P.C.I.J., ser. A, No. 21, at 121.

195. PLANIOL, *I TRAITÉ ÉLÉMENTAIRE DE DROIT CIVIL* 1173 (3d ed. 1939) *quoted in* 27 I.L.R. at 157.

196. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR,

capital importing countries, is clearly in favor of the states' legal orders as the governing law. The resolution declares:

2. The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the *rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities.*

3. . . . where authorization is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the *national legislation in force* and by international law.

4. [In case of controversies about compensation arising from nationalization, expropriation, or requisitioning] the *national jurisdiction of the state taking such measures shall be exhausted.* However, upon agreement by sovereign states and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication . . . .<sup>197</sup>

Subsequent resolutions of the U.N. and other international organizations, by omitting all references to international law, have reinforced the claims for applying national law and policy. They represent a rejection of any idea of "delocalizing" or "internationalizing" agreements between developing states and foreign investors. This was clear from the position taken in debates by representatives of the developing countries. For example, the representative of Iraq, in explaining the vote of his delegation in the General Assembly during debates on resolution 1803 (XVII)<sup>198</sup> in 1962, stated his view that "agreements signed between companies and sovereign States [are] simple contracts, governed and protected by the domestic laws of sovereign States" and found it "rather strange" and "illogical" for an international document such as the resolution under consideration to emphasize the observance of such contracts.<sup>199</sup> Mr. Schweitzer, the Chilean representative who was also on the Commission on Permanent Sovereignty, explained that the basic idea of the draft resolution of the Commission, in respect of agreements between states and foreign investors, is that the agreements are not immune to the laws of the states, but can be abrogated in the national interest against payment of compensa-

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Supp. (No. 17) 15, U.N. Doc. A/5217 (1962).

197. *Id.*

198. *Id.*

199. Permanent Sovereignty Over Natural Resources, Report of the Second Committee, 17 U.N. GAOR (1194th mtg.) 1133, 1135, U.N. Doc. A/5344/Add. 1 (1962).

tion as determined by the local laws.<sup>200</sup> The recognition of the right of the states to abrogate such contracts against payment of compensation affirms the legal position that such agreements are subject to local laws and policy; they could not be so treated if they had an international character.<sup>201</sup> The provision in paragraph 8, the operative paragraph of resolution 1803 (XVII), that “[f]oreign investment agreements freely entered into by or between sovereign states shall be observed in good faith,”<sup>202</sup> is an expression of a desirable policy that states, in their own interests, should not lightly disregard their agreements. It cannot be taken to mean that, as a matter of legal obligation, they could not do so.

#### IV. CONCLUSION

Past trends in decisions dealing with the laws governing economic development agreements and present realities combine to affirm the authority and control of national legal orders over the exploitation of the natural resources of a state. The present realities are that all states have made and are making claims to be the sole regulators of their natural resources. These claims are pursued at various levels of interaction in both internal and external arenas, and have largely been recognized by all. With particular reference to the developing countries, the numerous resolutions of the General Assembly on permanent sovereignty over natural resources and on a new international economic order, the resolutions and concrete actions of the natural resources producer organizations, such as OPEC, as well as the various actions of individual developing countries aimed at gaining full control over their natural resources, constitute important new factors which must be taken into account in making decisions about applicable law of economic development agreements. These new factors affirm the control of states over their natural resources. Such control can be effectively excluded only where there is conclusive evidence that a state has consented to such exclusion, but not otherwise.

The old argument based on the suggestion that the legal systems of developing countries are unsuitable for regulating complex economic development agreements has become untenable. That suggestion was first made in the *Abu Dhabi Award*, where an arbi-

200. 17 U.N. GAOR, C.2 (834th mtg.) 225, 230-32, U.N. Doc. A/C.2/SR. 834 (1962).

201. Case Concerning the Factory at Chorzów, [1927] P.C.I.J., ser. A, No. 17 at 31-32.

202. Permanent Sovereignty Over Natural Resources, G.A. Res. 1803, 17 U.N. GAOR, Supp. (No. 17) 15, 16, U.N. Doc. A/5217 (1962).

trator found that the state of the law of Abu Dhabi does not represent the law of Moslem countries.<sup>203</sup> This view was confirmed in the *ARAMCO Award*, which stated that Islamic law is one of the great legal systems of the world.<sup>204</sup> Where the appropriate legal system may appear to be inadequate to give full effect to the rights and obligations of the parties, the recognized national and international decisionmakers should be able to supplement, but not supplant, it with ideas from general jurisprudence and practices, customs, and usages of the particular natural resources industry. This process of enrichment, or what has been called "juristic chemistry,"<sup>205</sup> is the means of natural growth for all legal systems. The municipal laws of other states as well as international law, including the general principles of law universally recognized, form the sources from which ideas can be borrowed to enhance the legal systems of developing countries needing such enhancement.

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203. *Petroleum Dev. [Trucial Coast] Ltd. v. Sheikh of Abu Dhabi*, 18 I.L.R. 144 (1951).

204. *Saudi Arabia v. Arabian Am. Oil Co.*, 27 I.L.R. 117, 162 (1958).

205. See R. POUND, *THE FORMATIVE ERA OF AMERICAN LAW* 94-96 (1938).