

Law of International Business and Dispute Settlement in the 21st Century

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The Law Applied by International Arbitrators to State Contracts

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1. To speak of the law applied by arbitrators to the settlement of disputes arising out of contracts between States (or State-owned entities) and private parties means inevitably to review the essential terms of a doctrinal debate which has dominated during the last fifty years the subject of State contracts.

The solutions which have been adopted by international arbitrators, particularly – but not only – regarding disputes arisen out of petroleum concession agreements,¹ will allow, on one side, to verify the practical import of the various doctrinal theories which have been elaborated on the subject and, on the other side, to follow the development that the principles governing the matter have undergone during the time.

This development has been inevitably linked to and often conditioned by the progressive modification of the political and economic equilibrium which has characterized the history of the relations between the industrialized world and the developing countries particularly during the years '60 and '70s.

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1. The reference is to the following arbitration cases: (1) *Petroleum Development (Trucial Coast) Ltd. v. The Sheikh of Abu Dhabi*, award of 28 August 1951 by Lord Asquith of Bishopstone, International and Comparative Law Quarterly, 1952, 247; (2) *Ruler of Qatar v. International Marine Oil Company Ltd.*, award of June 1953, by Sir Alfred Buchnill (referee), 20 International Law Reports, 1953, 534; (3) *Government of Saudi Arabia v. Arabian American Oil Company (Aramco)*, award of 23 August 1958 by a tribunal composed of *Sauser-Hall, M. Hassan* and *Saba Habachi*, Revue critique de droit international privé, 1963, 272; 27 International Law Reports (1960), 117; (4) *Sapphire International Petroleum Ltd. v. National Iranian Oil Company (NIOC)*, award of 15 March 1963 by *Pierre Cavin*, 13 International and Comparative Law Quarterly, 1964, 1011; 35 International Law Reports, 1967, 136; Annuaire suisse de droit international, 1962, 273; (5) *BP Exploration Company (Libya) v. Government of the Libyan Arab Republic*, award of 10 December 1973 by *Gunnar Lagergren*, Revue de l'arbitrage, 1980, 132; (6) *Texaco Overseas Petroleum Company/California Asiatic Oil Company v. Government of the Libyan Arab Republic*, award of 19 January 1977 by *René-Jean Dupuy*, Journal du droit international, vol. 104, n. 2, 1977; International Legal Materials, vol. 17, 1977; (7) *Libyan American Oil Company (Liamco) v. Government of the Libyan Arab Republic*, award of 12 April 1977 by *Sobhy Mahmassany*, Revue de l'arbitrage, 1980, 117; (8) *The American Independent Oil Company (Aminoil) v. The Government of the State of Kuwait*, award of 24 March 1982 by a tribunal composed by *Paul Reuter* (Chairman), *Hamed Sultan* and *Sir Gerald Fitzmaurice*, International Legal Materials, 1982, 976; 9 Yearbook Commercial Arbitration, 1984, 71.

The widespread conviction prevails in this period that a State contract is governed by a national law, more precisely the law of the State where the activity is to be deployed, in application of the traditional conflict of law rules making reference to the law of the place of performance as being the law governing the contract. This position finds its support in the well-known decision of the Permanent Court of International Justice of 1929, according to which "any contract which is not a contract between States in their capacity as subjects of international law, is based on the municipal law of some country."³ By referring to a "municipal law of some country" this decision excludes the applicability to State contracts of public international law as well as of any a-national system of law. A conclusion which is drawn by the very structure and characteristics of the international legal system which governs only relations among subjects of the system in question. Private parties are not among such subjects and the circumstance that they may enter into a contractual relationship with a sovereign State would not be sufficient to confer upon such parties the status of subjects of public international law and destines of its rules.⁴

4. It is in the course of the 1950s that the problem of the law applicable to concession agreements with States (or State-owned entities) receives an increasing attention by the legal doctrine of industrialized countries. This attention is urged by events revealing, on one side, a gaining of conscience by States of their sovereign prerogatives and, on the other side, by the importance that also this issue may have in the more general context of the protection to be assured to the private investment.

Reference is made, in particular, to the nationalisation of the petroleum industry by the Mossadeq's government in Iran in 1951 and to some arbitral awards regarding petroleum concession agreements,⁵ specifically those that have concluded the following arbitral proceedings:⁶

(a) *Petroleum Development (Trucial Coast) Ltd. v. The Sheikb of Abu Dhabi*, where the dispute concerned the question whether the concession area under the 1939 agreement extended to the sub-soil of the territorial sea and continental shelf;

3. Arrêt of 12 July 1929, *Affaire concernant le paiement de divers emprunts serbes émis en France*, and *others v. The Government of Qatar*, Yearbook Commercial Arbitration, 1990, 34.

3 Arrêt of 12 July 1929, *Affaire concernant le paiement de divers emprunts serbes émis en France*, CPIJ, Série A, N° 20, p. 41 Annual Digest 5 (1929-1930), *Affaire N° 278*.

4 The classic solution has been indirectly confirmed by the International Court of Justice in 1952 when the Court has excluded its jurisdiction regarding the Agreement of 1933 between the Anglo-Iranian Oil Company and Iran considering that the said Agreement consisted of "rien de plus qu'un contrat de concession entre un gouvernement et une société privée étrangère", a conclusion excluding the nature of an agreement governed by public international law: *Affaire de l'Anglo-Iranian Oil Co. (Royaume Uni c. Iran)*, arrêt of 27 July 1952, 112.

5 *El Kosheri, Stabilité et évolution dans les techniques juridiques utilisées par les pays en voie d'industrialisation*, Le contrat économique international, Paris/Bruxelles 1975, 289.

6 All such awards are cited *in extenso* in note 1.

2. Starting point of this analysis is the consideration that the interests of the host State and those of the investor company are quite often antagonistic.

The private party aims at making a profit (often quite relevant) through the access to a steady source of supply of natural resources (be they oil or gas or other minerals) under a legally and contractually guaranteed protection of its substantial investment.

The State, in its turn, wishes to attract to its territory financial resources, technology, know-how and organizational skills which are badly needed for the development of its economy, without losing its sovereign prerogatives.

In a first phase, extending until the end of the 1960s, the State accepts to pursue its objectives by entering into contractual relations in which its formal position of a sovereign entity vis-à-vis the private party is counterbalanced by the latter's superiority regarding the actual control of the activity on the technical and economic plane and the marketing of the production. The juridical envelope which gives full expression to this divergent position of the two parties is the petroleum concession.

As its name indicates, the act underscores the sovereign power of the party which – being the exclusive title-holder to the mineral resources – *concedes* (grants) their exploitation to the private party, for a consideration which initially is limited to a fixed percentage of the production (the *royalty*), another name evoking the sovereign prerogatives of the grantor) to include only later on also taxes on income.

The concession agreement is marked by its long duration (extending initially for even sixty years), the very large surface of the areas over which the activity may be conducted on an exclusive basis and by the almost total control of the concessionaire over the exploitation rate and the market price of the products which have been discovered or extracted.

The express provision that the contractual terms and conditions may not be modified except by mutual agreement and the resort to international arbitration in case of disputes contribute to the making of the concession agreement of a kind of *enclave* impénétrable by any intervention of the State aiming at challenging the extent of the concessionaire's powers.

3. It is also for this reason that until the 1950s the issue of the law applicable to this type of State contracts does not receive a specific attention, as it is shown by the review of contracts concluded by countries of the Middle East in which a clause on the subject does not appear.²

2 The applicable law clause is also absent from the concession agreements originating the arbitrations mentioned in the previous note, except for those which were signed by Libya on the basis of the petroleum law of 18 July 1955 as amended in 1965, which incorporated the applicable law clause provided for by such law. It is significant that regarding two of said arbitral proceedings, the *Aramco* case and the *Aminoil* case, the parties have agreed on the applicable law in the arbitral proceedings.

(b) *Ruler of Qatar v. International Marine Oil Company Ltd.*, where the dispute concerned the question whether the first instalment of the yearly royalty is attributable to the preceding or the following year;

(c) *The Government of Saudi Arabia v. Arabian American Oil Company (Aramco)*, where the dispute concerned the question whether the *Aramco* concession of 1933 included the exclusive right to transport crude oil by sea so that the priority right accorded in 1954-1955 by Saudi Arabia to *Mr. Onassis* for the oil transport by sea could not be enforceable against *Aramco*.

All these decisions touch upon the issue of the law applicable to the concession agreement, the first two concluding for the exclusion of the applicability of the local law considering also its primitive character while the latter, more elaborated, confirms the applicability of Saudi Arabian law to which the parties had made reference, subject to certain qualifications which will be mentioned hereafter.

5. The award in the *Aramco* case starts from considering the agreement with the State as a *sui generis* atypical contract based on Muslim law as the *lex rei sitae*.

As stated by the arbitrator, *„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 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 only be able to create a contractual relationship if the applicable system of law has first recognized its power to do so.“*⁷

The arbitrator fixes then a further significant principle making reference to the decision of the Permanent Court of International Justice of 1929 concerning the *Serbian Loans* case:⁸ *„As the Agreement of 1933 has not been concluded between two States, but between a State and a private American corporation, it is not governed by public international law.“*⁹

The follow-up of the arbitrator's reasoning is entirely based on the traditional principles of private international law, first of all the principle of parties' autonomy which has to be recognized without limits in view of the international character of the Agreement (having been concluded between the Government of Saudi Arabia and a United States corporation). Since the parties have expressly chosen the law in force in Saudi Arabia for all questions coming within the Saudi Arabian jurisdiction,¹⁰ this choice seems reasonable

and must be upheld to the extent the parties have voluntarily adopted a legislation having a relation with the subject-matter of their contract.

Finally, according to the arbitrator Saudi Arabian law is applicable to the merits of the dispute since *„... it is generally admitted, in private international law, that a sovereign State is presumed, unless the contrary is proved, to have subjected its undertakings to its own legal system.“*¹¹ However, after having verified that in the *Aramco* concession agreement sovereign rights are inevitably mingled with the granting of private rights to the concessionaire the arbitrator, scarcely consistent with its reasoning based on private international law rules and the respect due to the parties' autonomy, specifies that the application of Saudi Arabian law has to find an important corrective factor in the fact that *„That law [of Saudi Arabia] 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; in particular, 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 laws in force in Saudi Arabia.“*¹²

A solution which seems justified to the arbitrator by the predominance recognized by the concession agreement to the English text (the interpretation of which is well established by a long usage and by the experience of similar contracts) but which, in reality, finds its *raison d'être* in the need – openly stated – to protect the private investment beyond and notwithstanding the applicable law.

6. The two other arbitral awards, in the *Abu Dhabi* case and in the *Qatar* case, are inspired by the same private international law principles with, however, a minor richness of argumentation than the one in the *Aramco* award. Both of them, in fact, search for the applicable law on the assumption of the contractual nature of the concession and, therefore, of the importance to be recognized to the parties' autonomy, identifying in principle the law of the State as applicable to the concession agreement.

The fact that the arbitrators conclude in both cases for the applicability of the principles of natural justice and fairness, is not due to certain indices contained in the concession agreements but, rather, to the common observation regarding the absence in the two countries of a *„settled body of legal principles... applicable to the construction of modern commercial instruments.“*¹³

7. The conclusion which may drawn from these first arbitral awards cannot but place emphasis on the fact that the arbitrators, although basing initially their reasoning on

ment au droit que le Tribunal jugera applicable, dans la mesure où il s'agit de questions en dehors de la juridiction de l'Arabie Saoudite" (Convention d'Arbitrage, art. IV).

11 27 International Law Reports, 1963, 167.

12 27 International Law Reports, 1963, 169.

13 *Abu Dhabi* award, International and Comparative Law Quarterly, 1952, 251; *Qatar* award, 20 International Law Reports, 1953, 544.

7 27 International Law Reports, 1963, 165.

8 *Supra*, note 3.

9 27 International Law Reports, 1963, 165.

10 „Le Tribunal arbitral tranchera ce litige (a) conformément au droit arabo-saoudite ... dans la mesure où il s'agit de questions rentrant dans la juridiction de l'Arabie Saoudite; (b) conformé-

the conflict of law rules approach leading to the identification of the local law as the only law applicable to the State contract, conclude for justifying the applicability either on an exclusive basis (in the *Abu Dhabi* and *Qatar* cases) or as a corrective factor (in the *Aramco* case) of different systems or principles, denominated in various way (*„modern law of nature“*, in the *Qatar* case, *„general principles of law“*, *„usages applied in the petroleum industry“* and *„pure legal science data“*, in the *Aramco* case).

For the first time the arbitrators manifest the tendency to discard the applicability of a municipal law, particularly that of the State party to the contract, to favour the *delocalisation* or *denationalisation* of the State contract. A process which is sometimes justified by the international arbitrator in consideration of the State's double capacity by which it concludes such contract: as a sovereign entity, when it confers privileges and exemptions to the private party in derogation of rules of general application; as a co-contracting party, when it stipulates rights and obligations on a private law level with the private investor. A result which is pursued by the international arbitrator, in this phase, even beyond the parties' agreement regarding the applicable law with the stated intent (as in the *Aramco* case) of ensuring a better protection to the private investment.

8. The way to the denationalisation (or even the internationalisation) of State contracts had been paved in the 1950s by the appearance of clauses, conceived by ingenious Western law firms particularly in the most widespread type of State contract, the economic development agreement, making provisions for the application of rules of non-national origin in lieu of the classical choice-of-law clause referring to a municipal system of law.¹⁴

14. An inventory of choice-of-law clauses found in contractual practice between State entities and foreign private enterprises results from a research carried out about thirty years ago by the personality to whom this contribution is devoted (*Böckstiegel*, *Der Staat als Vertragspartner ausländischer Privatunternehmen*, 1971). The subject has been dealt with by the same personality in a more recent study (*Böckstiegel*, *Arbitration and State enterprises*, 1984, 27ss.). Examples of choice-of-law clauses may be found in concession agreements concluded in the 1950s with Middle-Eastern States, such as the following: „In view of the diverse nationalities of the parties of this Agreement, it shall be governed by and interpreted and applied in accordance with 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 of law recognized by civilized nations in general, including such of those principles as may have been applied by international tribunals“ (art. 46, *Consortium Agreement in Iran of 1954*); „Compte tenu des différentes nationalités de parties au présent Accord, ce dernier aura valeur et devra être interprété et appliqué conformément aux principes communs de loi en vigueur en Iran et en Italie et à défaut de ces principes conformément aux principes de droit reconnus comme normaux par les nations civilisées, notamment ceux qui ont déjà été appliqués par les Tribunaux internationaux“ (article 40 de l'Accord entre la *Société Nationale Iranienne des Pétroles* et la *Société AGIP Mivertaria* du 24 août 1957). „The parties base their relations with regard to this Agreement on the principles of goodwill and good faith. Taking account of their different nationalities this Agreement shall be given effect and must be interpreted and applied in conformity with the principles of law common to Kuwait and Japan and, in the absence of such common principles, then in conformity

The presence of clauses having this content or the very absence of any choice-of-law provision in a State contract prompts the formulation of a number of theories which dominate the legal debate on the subject during this period.

Contrat sans loi (self-regulatory contract), i.e. a contract which is governed only by its own provisions without the need of resorting to some external system of law;¹⁵ public international law; transnational law as a system differing both from municipal law and public international law;¹⁶ a component of which are the general principles of law;¹⁷ a combination of these different legal systems: all these theories, whatever their denomination, have one common finality, that of subtracting the State contract to the domain of the municipal law of the State and to the consequent risk that the same be modified to its advantage (*„aléa de souveraineté“*).

9. Preceded by the doctrinal debate to which reference has been made above, the arbitral award in the *Sapphire* case¹⁸ takes firm position in favour of the denationalisation of the concession contract which had been concluded on 16 June 1958 on the basis of the Iranian petroleum law of 1957.¹⁹

with the principles of law normally recognized by civilized states in general, including those which have been applied by international tribunals“ (art. 39, *Offshore Concession Agreement between the Government of Kuwait and Arabian Oil Co. Ltd.* of 5 July 1958).

15. *Verdross*, *Protection of Private Property under Quasi-International Agreements*, *Nederlands Tijdschrift voor Internationaal Recht*, 1959, 355; *Bonny*, *Arbitration and Economic Development Agreements*, *The Business Lawyer*, 1960, 860. This theory has been criticised by *Marr*, *The Proper Law of Contracts concluded by International Persons*, *British Yearbook of International Law*, 1959, 34.

16. *Weil*, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, *Recueil de Cours de l'Académie de droit international*, 1969 (III), 189; *Rigaux*, *Droit public et droit privé dans les relations internationales*, 1977, par. 196; *Id.*, *Des dieux et des héros - Réflexions sur une sentence arbitrale*, *Revue critique de droit international privé*, 1978; 435; *Id.*, *Contrats d'Etat et arbitrage transnational*, *Rivista di diritto internazionale*, 1984, 496; *Giardina*, *State Contracts: National versus International Law?* *The Italian Yearbook of International Law*, 1982, 147.

17. *McNair*, *The General Principles of Law recognized by Civilized Nations*, *British Yearbook of International Law*, 1957, 1; *Jessup*, *Transnational Law*, 1956; *Fatouros*, *Guarantees to Foreign Investors*, 1962, 288. This theory has been criticised by *Delamare*, who has defined this alleged „tiers ordre“ „misterieux dans sa nature, mal défini dans son champ d'application“ (*Des stipulations de droit applicable dans les accords de prêts et de développement économique et de leur rôle*, *Revue belge de droit international*, 1968, 363).

18. *Supra*, note 1.

19. The following justification for the denationalisation of State contracts may be read in the award in the *Sapphire* case: „... la société étrangère apportait à l'Etat iranien une aide financière et technique comportant pour elle des investissements, des responsabilités et des risques étendus. Il apparaît dès lors normal qu'elle soit protégée contre des modifications législatives susceptibles de modifier l'économie du Contrat et qu'une certaine sécurité juridique lui soit assurée, ce que ne pourrait lui garantir l'application pure et simple du droit iranien, qu'il est au pouvoir de l'Etat iranien de modifier...“ *Annuaire suisse*, cit. 284.

The arbitrator is called upon to decide on the claim for damages raised by the company by reason of the alleged non-performance of the contract by *NIOC*. In the absence of an applicable law clause, he excludes first of all the applicability of Iranian law as well as of any other municipal law based on the common intention of the parties as inferred by the contract itself. Among the contractual elements allowing for such conclusions the arbitrator refers to:

- the presence of a clause of international arbitration which would evidence the parties' intent to exclude the application of Iranian law;²⁰
- the contractual provision according to which the parties undertake to execute the contract in conformity with the principles of good faith and good will, respecting the spirit as well as the letter of the contract: such provision is held by the arbitrator difficult to reconcile with the application of the internal law of Iran and to call rather for the application of general principles of law.

This conclusion appears to the arbitrator to be warranted by the reference made in the force majeure clause to the principles of international law.²¹ The general principles of law which are stated to be applicable are to be derived from the positive law of civilized nations. It is curious to note that the two principles which are found by the arbitrator to be at the basis of his decision, *pacta sunt servanda* and *inadimplenti non est adimplendum*, constitute principles which are known also to the Iranian legal system, the application of which had been discarded since the very beginning.

10. About ten years separate the *Sapphire* case from the three arbitral cases originated by the nationalization in Libya of petroleum concessions between 1971 and 1974.

During this period the relations between the industrialized world and the developing countries undergo an unrelenting and progressive evolution, a circumstance having a bearing on the bargaining power of Western investors over host States.

On a more general plane, numerous resolutions which are adopted by the U.N. General Assembly under pressure by Third World countries proclaim the States' permanent sovereignty over their natural resources (thus making legitimate any process of nationa-

lization as manifestation of such sovereignty) as well as the establishment of a *new international economic order* which would govern the North-South relations.²²

At regional level, the steadfast action of the petroleum exporting countries, organized through OPEC from the year 1960, brings about a deep modification in the contractual relations with the petroleum companies leading progressively to the elimination of the petroleum concession, the latter being considered as the expression of the „old economic order“.²³

In this context, characterized by the States' progressive recovery of their sovereign prerogatives and by the changed attitude of Western investors, including the large multinational oil companies which accept to redefine their contractual relations with host States, the Libyan nationalization of the petroleum industry and the three ensuing arbitration cases²⁴ mark an exception to a process which until then had developed, despite some deep contrasts, in a climate of relative mutual understanding.

What is remarkable in the three Libyan cases is the circumstance that notwithstanding the substantial identity of both the facts and the contractual provisions governing the relations between the Libyan government and the concessionaires, the three awards have a certain number of common points but differ significantly regarding specifically the issue of applicable law.²⁵

The developments reserved to this issue have a crucial importance since the question of the validity of an act of nationalisation determining a contractual relationship under a State contract was at stake. According to a widespread doctrine, if the applicable law is the legal system of the nationalising State, the nationalisation law is part of such legal system and founds thereon its legitimacy. Should the applicable law be other than the State law, the act of nationalisation, although legitimate on the international plane, will bring about a breach of contract for which the State is liable.

In view of determining the law applicable to the merits of the dispute the arbitrators consider initially the nature of the petroleum *concession* to conclude - more or less explicitly - that the relations which are established between the State as granting authority

22 Resolution n. 1803 (XVII) of 14 December 1962 relating to the „Permanent Sovereignty over Natural Resources“; Resolution n. 3201 (S-VI) of 1st May 1974 entitled „Declaration relative to the Establishment of a New International Economic Order“; Resolution n. 3281 (XXIX) of 12 December 1974 proclaiming the „Charter of Economic Rights and Duties of States“ (Charter of Algiers).

23 The most significant expression of OPEC's policy in this field is represented by Resolution n. XVI-90 (Declaratory Statement of Petroleum Policy in Member Countries) of 24-25 June 1968, International Legal Materials, 1968, 1183.

24 *Supra*, note 1.

25 The three cases are commented by Stern, Trois arbitrages, un même problème, trois solutions, Revue de l'arbitrage, 1980, 22-23, and by Verhoeven, Droit international des contrats et droit des gens, Revue belge de droit international public, 1978-1979, 215.

20 „... si aucune déduction ne peut être tirée de la clause arbitrale, il est permis d'y voir un indice négatif, dans le sens du rejet de l'application exclusive du droit iranien ...“: *ibid.*, 285.

21 *Ibid.*, 286: „Il est caractéristique que, dans la seule clause de leur contrat qui précise une notion conventionnelle par une référence à un système juridique déterminé, les parties ne se soient pas reportées à la loi iranienne qui pourtant connaît cette notion ... ni au droit d'aucune autre nation, mais qu'elles fassent appel aux principes généraux du droit international, qu'elles déclarent expressément applicables“. A critical review of the *Sapphire* award is offered by Delaume, The proper law of State contracts and the *lex mercatoria*: a reappraisal, ICSID Review-Foreign Investment Law Journal, 1988, 86.

and the concessionaire have a contractual nature even if they enjoy specific characteristics by reason of the presence of a sovereign entity as a party and of the regulation, under the concession agreement, of matters falling within the purview of sovereign prerogatives.²⁶ As a consequence, the arbitrator in the *Liamco* case holds that one is in the presence of a private law contract and not of an administrative contract or, more generally, of a public law contract.²⁷ The same solution is adopted by the arbitrator in the *BP* case.

The developments in this regard of the arbitrator in the *Topco/Calasiatic* case are much more elaborated in view also of the importance of this aspect on the issue of the legitimacy of the Libyan act of nationalization. As a matter of fact, should the concession constitute an administrative contract the State will have the power, under certain circumstances, to modify it and even to unilaterally terminate the same for reasons of public interest.²⁸ This conclusion is rejected by the arbitrator based on the consideration that the presence of a *stabilisation* clause constitutes a negation of one of the main features of an administrative contract, its basically uneven (as to the parties' respective position) character.

Once the nature of the concession as a private law contract recognized, the three arbitrators hold that its foundation is the parties' autonomy.²⁹ This leads the arbitrators in the *BP* and *Liamco* cases to confirm the validity of the choice of law made by the parties in clauses 28 of the concession contract,³⁰ without further developments.

On the contrary, the arbitrator in the *Topco/Calasiatic* case undertakes a thorough analysis concerning the contractual connecting factors leading to the conclusion, based on a number of contractual elements (such as the reference in the contract to the general principles of law and to an international arbitration clause), that public international law is the governing law. The justification for such *internationalisation* is found by the arbitra-

tor in the need of protecting the private party against unilateral and brutal modifications by the contracting State of its legislation.³¹

The interpretation of the concession choice of law clause leads the three arbitrators to entirely different conclusions.

The arbitrator in the *BP* case excludes that the clause in question implies the applicability of the Libyan law only or of public international law only or only of the contract. One has initially to apply "the principles common to Libyan law and to public international law" and then, but only in case the interpreter will not find such common principles, "the general principles of law". The latter are interpreted as corresponding to general principles of internal laws.³²

According to the award in the *Topco/Calasiatic* case, on the contrary, Libyan law is not placed on the same plane as public international law, the latter governing in any case the contract by virtue of the reference made by the clause to first of all the "principles of international law" and, subsidiarily, to the "general principles of law". In order to reach this result, the arbitrator identifies the latter principles with those referred to by article 38 of the Statute of the International Court of Justice as one of the sources of public international law.³³

The solution of the *Liamco* award is again different. The arbitrator interprets the choice of law clause as implying that "la loi régissant le contrat de concession de *Liamco* ... est d'abord la loi de Libye quand cette dernière est en accord avec le droit international, et subsidiairement les principes généraux du droit."³⁴ The Libyan principles include not only the legal provisions but also the principles of Islamic law, custom, natural law and fairness (*équité*), to which reference is made as subsidiary sources of law by art. 1 of the Libyan civil code. In order to identify the international law principles, the arbitrator refers to art. 38 of the Statute of the International Court of Justice. As to the general principles of law indicated by the clause as a subsidiary source, the arbitrator identifies them in the maxims incorporated in the majority of legal systems "universally accepted in theory and in practice".

As to the nature of the reparation due to the nationalized concessionaires, the different solutions so found as to the applicable law lead the arbitrators in the *BP* and *Liamco* cases to exclude the *restitutio in integrum* in the absence of principles on the subject common to Libyan and international law. According to the award in the *Topco/Calasiatic* case, on the contrary, both the principles of Libyan law and public international law

31 *Topco/Calasiatic* award, Journal de droit international, cit., 359.

32 *BP* award, Revue de l'arbitrage, cit., 123-124.

33 *Topco/Calasiatic* award, Journal de droit international, cit., 358.

34 *Liamco* award, Revue de l'arbitrage, cit., 139-142.

26 "Bien qu'un contrat de concession ait un caractère à la fois de droit public et de droit privé, sa nature prédominante est assurément contractuelle" (*Liamco* award, Revue de l'arbitrage, cit., 135).

27 "... les activités du concessionnaire dans les concessions minières pétrolières ou analogues n'ont pas un caractère de service public, mais elles sont considérées comme des projets et entreprises de caractère privé. Comme telles, ces concessions sont en général régies par les principes de droit privé régissant les contrats" (*Liamco* award, ibidem, 1980, p. 135).

28 *Topco/Calasiatic* award, Journal de droit international, cit., 364.

29 Parties' autonomy is founded on Danish law by the *BP* award, on public international law by the *Topco/Calasiatic* award and on the principles of private international law by the *Liamco* award.

30 Clause 28, paragraph 7, of the Libyan concession agreements reads as follows: "The concession shall be governed by and interpreted in accordance with the principles of law of Libya common to the principles of international law and in the absence of such common principles, then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals."

integral part of the law of Kuwait, the general principles of law correspondingly recognize the rights of the State in its capacity of supreme protector of the general interest.⁴⁰

By referring at the same time to Kuwaiti law and to the general principles of law and by reconciling these two sources of law the tribunal gives satisfaction at the same time to the State, which had claimed the applicability of its own laws to the whole of the issues in dispute, and to *Aminoil*, which had contended the exclusive applicability of general principles of law.

13. The *Aminoil* award, by recognizing the applicability of the law of the host State and, at the same time, of international law as part of the national law, marks an important step in the development of the conceptions in the matter.

On one side, the award rejects the notion of transnational law as a third order between international and national law; on the other, it implicitly recognizes that neither the quality of a party as a State nor the nature of the agreement justifies, in the absence of a clear will of the parties, the application of public international law as the exclusive system governing the parties' relations. A solution, the latter, which is rendered by far less acceptable by reason of the evolution undergone by State contracts since the 1970s, marked, on one side, by the entering into the scene of State-owned entities as signatory parties in lieu of the State and, on the other, by the private law nature of the new types of agreements (service contracts; technical assistance contracts; build-operate-transfer agreements).

Hence, the tendency of these new agreements to make applicable the law of the host State, a circumstance allowing a leading scholar to speak of a process of *delocalization* of the State contract in the ambit of the municipal law of the host State.⁴¹

The blend of State law and international law, which is the best result of the *Aminoil* award, represents a well-balanced solution to the delicate problem of the law applicable to State contracts to the extent that the differing interests at the stake are thus reconciled with better legal rigorism than that underlying the several arbitral awards to which reference has been made above.

The international arbitrators' tendency to mitigate the applicability of the State law by the concurrent reference to other principles (be they "general principles of law" or "principles of international law") persists even in the presence of the parties' choice of the law of the State (or of the State entity) party to the contract. In the context of an ICC arbitration, this concurrent reference may be partly justified by the rules of arbitration of that institution directing the arbitrator to take into account in all cases (*i.e.*, also in the presence of a parties' choice of law) of trade usages. This leaves open the question,

40 *Ibidem*, 1001.

41 *Delorme*, The proper law of state contracts revisited, ICSID Review-Foreign Investment Law Journal, 1997, 2. On the same issue, *Giardina*, State contracts; National versus International Law?, *cit.*, 161.

provide for the *restitutio in integrum* as the normal sanction for the non-performance of contractual obligations.³⁵

12. The importance of the three Libyan cases for the ensuing developments regarding the issue of the law applicable to State contracts is undeniable.

A subsequent arbitration proceedings between the Government of Kuwait and *Aminoil*³⁶ has marked a significant step in the way of revisiting the question of the proper law of State contracts. Contrary to the Libyan cases where the State was absent, Kuwait took active part in the arbitration.³⁷

The dispute arose out of the nationalisation by Kuwait of a petroleum concession granted to *Aminoil* in 1948 with the guarantee of stabilization of the contractual conditions. For what is here of interest, the arbitration agreement of 23 July 1979 contained an applicable law clause reading as follows:

*"The law governing the substantive issue between the Parties shall be determined by the Tribunal having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world."*³⁸

As one may note, this vague formulation points rather to a rule of conflict, the parties having failed presumably to find an agreement on the direct choice of the applicable law. The tribunal finds without difficulty that Kuwaiti law "applies to many matters over which it is the law most directly involved."³⁹ No precision is offered, however, as to which are the matters to which Kuwaiti law should apply or which law should apply to other matters. To the extent the applicable law clause requires to be interpreted, such interpretation should be based, according to the tribunal, on the clause that the parties had agreed in principle in a draft contract of 1973 reflecting provisions found in petroleum concession agreements in Kuwait. Since the clause in question referred to "principles common to the laws of Kuwait and of the State of New York" and, in their absence, to the "general principles of law recognized by civilized nations", the tribunal reintroduces these principles as a source of the law applicable in this case.

The tribunal further determines that the various sources of law that it is called to apply are not in contradiction one with the other. "Indeed — adds the Tribunal in the most significant passage of the award — if, as recalled above, international law constitutes an-

35 *BP award*, *Revue de l'arbitrage*, *cit.* 127-129; *Topco/Casasiatic award*, *Journal de droit international*, *cit.*, 380-387; *Liamco award*, *Revue de l'arbitrage*, *cit.*, 167-170.

36 *Supra*, note 1.

37 *Redfern*, The arbitration between the government of Kuwait and *Aminoil*, 54 *British Yearbook of International Law*, 1985, 109.

38 *International Legal Materials*, *cit.*, 980.

39 *Ibidem*, 1000.

however, whether "general principles of law" or similar references may properly be characterized as "trade usages".⁴²

14. The problems and resulting uncertainties originated by the absence of stipulations of choice-of-law provisions, or by the way such stipulations are formulated, as shown by the awards which have been considered above, are to a certain extent overcome in the case of application of the Washington Convention of 1965, as shown by awards rendered pursuant thereto.

Under art. 42(1) of the Convention, the parties may decide, in the exercise of their autonomy, to subject their investment agreement to "rules of law", a formula designed to include not only domestic law but also public international law or other a-national systems or combination of rules (such as general principles of law, principles common to various states or even the *lex mercatoria*). Failing such express stipulation, the arbitral tribunal shall have to apply the law of the host State "and such rules of international law as may be applicable".⁴³

Notwithstanding the undeniable progress marked by the Convention regarding the thorny problem of the law applicable to State contracts, questions remain open as shown by a series of awards in which arbitrators were called upon to interpret this provision.

15. No particular guidance is offered regarding the hierarchy between the State domestic law and international law, both systems being referred to without any apparent differentiation.

Two decisions rendered under the Washington Convention have clarified that under normal circumstances the tribunal has first to determine the content of the State law and then to test its conformity with the principles of public international law.

The award in the case *Klöckner v. Cameroon* was annulled on the ground that the tribunal had rendered its decision based on international law without having first established the content of the host State law.⁴⁴

42 An example of this kind of solution is offered by the award of 30 April 1982 in the ICC case *Framatome, Alsthom-Atlantique and Spie Batignolles v. Atomic Energy Organization of Iran* (Journal du droit international, 1983, 914; Collection of ICC Arbitral Awards, 1974-1985, 161), commented by *Oppetit*, Arbitration et contrats d'Etats. L'arbitrage *Framatome et autres* c/ *Atomic Energy Organization of Iran*, Journal du droit international, 1984, 37.

43 Art. 42(1) of the Washington Convention reads as follows: "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."

44 Decision of the ad hoc Committee of May 3, 1985, published (in excerpts) in 114 Journal du droit international, 1987, 163 and at ICSID Review-Foreign Investment Law Journal, 1986, 89. It is interesting to note that the ground for annulment relied upon in this decision is the fact that the tribunal had "manifestly exceeded its powers", which is one of the few grounds for annulment contemplated by art. 52(1) of the Convention.

In the *Letco v. Liberia* case the tribunal had construed the reference made in the preamble of the concession agreement to the General Business Law of Liberia as a choice of law. Even if such reference were not to be so construed by the parties, Liberian law would be applicable, according to the tribunal, under the second part of art. 42(1) of the Convention. Having then examined the question posed by the concurrent reference of such provision to international law, the tribunal stated that "the law of the contracting state is paramount within its own territory, but is nevertheless subjected to control by international law", to then conclude that the rules of Liberian laws were "in conformity with generally accepted principles of public international law governing the validity of contracts and the remedy for their breach."⁴⁵

16. It may be concluded from this review that under art. 42(1) of the Washington Convention public international law intervenes both to fill a gap in the domestic law of the host state and to prevent the application of a domestic rule which is not in conformity with rules of international law.⁴⁶

A summary of this interpretation of the concurrent reference to the State law and to public international law is contained in the new award rendered after the annulment of the prior award in the *Amco Asia et al. v. Republic of Indonesia*.⁴⁷

"This Tribunal notes that Art 42(1) refers to the application of host-state law and international law. If there are no relevant host-state laws on a particular matter, a search must be made for the relevant international laws, they must be checked against international laws, which will prevail in case of conflict. This international law is fully applicable and to classify its role as "only" "supplemental and corrective" seems a distinction without a difference. In any event, the Tribunal believes that its task is to test every claim of law in this case first against Indonesian law, and then against international law".

More difficult is the answer to another question left open by Art. 42(1), namely whether public international law has a role to play also in case the parties have expressly chosen a domestic system of law to govern their relationship under the first part of the provision. One might contend in this respect that the arbitral system created by the Washington Convention, based as it is on an international law instrument providing for the suspension of any recourse to diplomatic protection by the investor's State during the proceedings (art. 27(1)) and for other relevant effects of international law, is so integrated into public international law as to make it unthinkable that a State law would be applied by an ICSID tribunal if contrary to a rule of public international law. It must therefore be presumed that when the parties have made reference to a particular State law without

45 *Liberian Eastern Timber Corporation (LETCO) v. Government of the Republic of Liberia* (ICSID case n° ARB/83/2), Award of March 31, 1986, 26 International Legal Materials, 1987, 647, 658.

46 A typical example of such non-conformity is represented by a nationalisation measure not accompanied by a provision for the payment of prompt and adequate indemnification.

47 Award of May 31, 1990, Yearbook Commercial Arbitration, 1992, 76; Journal de droit international, 1991, 172 (excerpts in French translation).

further qualifications they have assumed the conformity of such law with the rules of public international law.

17. The conclusion which may be drawn the foregoing analysis is that the issue of the law applicable to State contracts is no longer viewed in terms of confrontation between a defenceless investor and a State whose incomplete system of law and permanent sovereign power justified the fears of a State intervention to the detriment of the investor's rights. Such risk appears today significantly mitigated by States' participation to a network of international conventions, such as the ICSID Convention⁴⁸ or the Multilateral Investment Guarantee Agency (MIGA) Convention.⁴⁹

To be able to offer security and stability to foreign investors and thus induce a greater flow of foreign direct investment in development projects, States should be amenable to accept those provisions which may infuse into the deal an acceptable measure of confidence.

Among such provisions are those providing for the renegotiation of the contractual conditions in specified circumstances,⁵⁰ for the application to the investment contract of both the host State law and public international law and for international arbitration as a dispute-settlement method.

Provisions of this nature may help in achieving a fair balance between the State's long-term development objectives and the economic and business interests of the foreign investors. Once achieved, this balance is by itself a guarantee of stability of the parties' relations under a State contract.

48 The ICSID Convention has 133 Contracting States as of 31 December 2000.

49 The MIGA Convention has 154 Contracting States as of 31 December 2000.

50 *Bernardini*, The renegotiation of the investment contract, ICSID Review-Foreign Investment Law Journal, 1998, 711.