The Law Applicable to Concession Agreements: The Ethiopian Case

By
Muluneh Worku

Advisor
Getachew Abera (Associate Professor)

A Thesis Submitted to the School of Graduate Studies of Addis Ababa University in Partial Fulfillment of the Requirements for the Degree of Master of Laws in Law Faculty

May 2005

The Law Applicable to Concession Agreements: The Ethiopian Case

By
Muluneh Worku

Advisor
Getachew Abera (Associate Professor)

A Thesis Submitted to the School of Graduate Studies of Addis Ababa University in Partial Fulfillment of the Requirements for the Degree of Master of Laws in Law Faculty

May 2005

TABLE OF CONTENTS

ACKNOWLEDGEMENT

First and foremost my dear thanks goes to my parents, Seargeant Worku Ayanlem and W/o Enkuayehush Ambaye, for they cheerfully extended material and moral support. Members of my family, brothers, sisters, relatives and friends take most of the credit for accomplishment of the present work.

Special gratitude is due to my advisor, Getachew Abera (Associate Professor). His valuable and constructive comments made the work fruitful.

I am indebted to Muradu Abdo (Lecturer at the Law School, AAU), Widu Abate and Woretaw Mengistu as they kindly assisted me in making the work possible. The hospitality I received form people in the legal departments of Ethiopian Roads Authority, Ministry of Mines and Ethiopian Investment Commission is unforgettable. I really thank them. I appreciate Rahel Arefayne who tirelessly typed the whole work. Ultimately, God, I thank you for your indescribable gift.

Mulune h Worku

INTRODUCTION

We are in the age in which the trading activities of states are increasing everywhere. States have hardly been able to make good their capital from their sources only. In practice it has become apparent that none of the new states has been in a position to survive without the help foreign capital can give. States exporting capital in turn have interest in the market and the resources of developing countries. This situation demonstrates the necessity of mutual economic co-operation between states.

This economic co-operation has been done not only by nations alone. Many private institutions, business organizations and individuals have been involved in transnational economic relations.

Nor is it governments alone which have been signatories to agreements. States sign agreements with foreign individuals or organizations to define their relations. Agreements have been entered into between sovereign states and foreign private nations or companies for the development of natural resources, the construction and maintenance of public utilities, the building of railroad, and other activities, where the foreign private national or company has the capital, the managerial skills and the technical know-how needed by the sovereign for national development.

Private nationals that make investments in others states want to be sure that the later will not interfere with their contractual rights. Capital importing states tend to subject such contractual relations to their own legal regime, whereas foreign investors insist in a non-municipal legal protection of their rights. State's responsibility for losses arising out of contractual relations between the state and an alien investor is clearly of great

actuality. The task of this paper, therefore, is to deal with a legal regime which governs contractual relations between states and foreign investors.

In the first chapter some general points relating to the study are considered. The nature of and the need for concession agreements are explained. The problem and the scope of the work and the assumption on which the study is based are pointed out, as well.

A concession agreement reflects an aspect of the process of foreign investment in which an alien undertakes to bring capital and skilled manpower to the host state, and the latter promises to create favorable environment for the work of the alien. As such concession agreements aim at economic development. This purpose would be best served only when the agreement is given legal protection.

The question at the heart of the study is, therefore, whether concession agreements are subject to municipal law or international law. In answering this questions the study limits itself to the problem of state responsibility arising from non-observance of its contractual commitments.

To some extent arguments as to the governing law of concession agreement is based on the relative position of the parties to the contract. One of the parties to the agreement is a state while the other is a foreign company or an alien individual. The second chapter addresses the question whether this difference in the quality of the parties has an effect on the type of legal system applicable to concession agreements. In this part detail discussion of different authorities that favour municipal law or international law is made.

For those who hold the view that international law is the governing law of concession agreements, there remains one more question, i.e., whether these agreements are binding in international law. The weight of the authority is that concession agreements bind the parties. This rule, however, is not without exception. There are circumstances under which an agreement may be lawfully breached. This issue of sanctity of concession agreements together with the remedies available in case of unlawful breach of agreements is treated in chapter three.

The last chapter is about the trend that has been adopted in Ethiopia with respect to the subject under study. Attempt is made to infer the position followed at different times by examining the content of laws, treaties and concession agreements that has existed from time to time.

The study is based upon the combination of different sources. The writings of distinguished scholars, decisions of international courts and international tribunals, resolutions of international organizations, and state practice as can be inferred from pleadings before courts and tribunals, treaties and concession agreements are used.

As to the terminology, the phrase "international law" is used to refer to any rule or principle of law other than national law of a state. And the terms "concession agreements", "agreement", "contract" and other similar expressions are used interchangeably.

CHAPTER ONE

GENERAL

1.1 The Nature of Concession Agreements

Before considering what system of law is the most appropriate for the regulation of concession agreements and for the settlement of disputes arising thereunder, it is useful to note certain characteristics which they commonly present. Under the term "concession agreements" may be included all kinds of contracts whereby a state grants to foreign private persons or corporations certain powers and rights which would otherwise belong to itself only.[1] They, thus, include contracts granting to aliens the right to exploit the natural resources of a country, to operate enterprises of public utility, to supply goods necessary for the operation of state's public services, to do construction activities, etc. As such it has been said that "a concession always involves a more or less complicated system of rights and duties between the concessionaire on the one hand and the state on the other."[2]

A concession agreement reflects an aspect of the process of foreign investment. It is an instrument of coordination whereby a state and a foreign investor establish a complementary system of relationships in the conduct of an enterprise for a defined period.[3] It includes the grant by the state to the concessionaire of the privilege to enter into the system of economic relationships defined by the instrument. Kenneth S. Carlston characterizes a concession agreement as means of co-ordination, and the

---

[1] A.A. Fatouros, Government Guarantees to Foreign Investors, New York, Columbia University Press (1962), p. 233

[2] D. P. O'Connell, The Law of Sate Succession, London, Cambridge University press (1966), p. 107

[3] Kenneth S. Carlston, "Concession Agreements and Nationalization", American Journal of International Law (Vol. 52, 1958), Washington, D.C., Lancaster Press , Inc., p. 261.

grant of privilege by state as mere incident of such coordinated activity contemplated by the agreement.[4]

A concession agreement is characteristically found to be a means for the development of the mineral resources of the state. It is also, as indicated here-in-above, found useful in the development of public utilities and in other economic fields. Thus, Hyde suggests concession agreements be named "international economic development contracts."[5]

Evident from the afore-said characteristics of concession agreements is that mostly they are not contracts for the carrying out of a single transaction of sale or purchase. They provide for some long-term exploitation of natural resources and involve permanent installations. As such they involve the creation of right to possess large areas of territory of the contracting state, and the right to exercise a considerable amount of control within these areas.

Concession agreements are contracts made between states, which have natural resources or other phases of the economy awaiting development but not enough capital or skill available for that purpose, and corporations or individuals belonging to states which have capital and skill. They are made between a government on the one side and, on the other, a foreign corporation owing its legal existence to the law of a foreign state and driving its capital from nationals of that state. They therefore contain a foreign element, indeed an international element, using the word "international" not in the sense of "interstate", but as denoting an agreement between the parties which belong to two different countries. Concession agreements are, thus, characterized as quasi-

---

[4] Ibid.

[5] James N. Hyde, "Permanent Sovereignty Over Natural Wealth and Resources", American Journal of International Law (vol. 50, 1956), Washington, D.C., Lancaster Press Inc., p. 862.

international agreements.[6] One of the parties is a state, the other a foreign national. The agreement generates economic movement both to and from the state.[7] Performance of the operation under the agreement requires that materials, facilities, and skilled men be brought into the local area from beyond the borders of the state. The company-produced products go from the respective sources to many foreign countries.

A concession agreement is not in fact a treaty, since one of the parties is a private individual or corporation. Nor is it simply a private contractual agreement, since the other party is a sovereign state. The state of the individual or corporate party to the agreement is also frequently involved, as the capital or skilled manpower has the origin in it.

In entering into a concession agreement each party has its own interest. Usually a state's purpose in making a concession agreement is to have the natural resources developed and revenue obtained.[8] The state's purpose includes a desire to energize the state's economy, to enhance the productivity of the state's citizens and raise their living standards by obtaining the capital, tools, and skills. The reason for the concessionaire's interest is to find the natural resource, to produce it and to exchange that production for enough money to meet its agreement obligations and to pay for this efforts.[9] The nature of such a relationship implies concessionaire's confidence that the state will protect it in the exercise of the rights and performance of the obligations created by the agreement.

---

[6] Alfred Verdross, "The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 133.

[7] Kenneth S. Carleston, "International Role of Concession Agreements", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 243.

[8] Q. C, McNair, "The General Principles of Law Recognized by Civilized Nations", The British Year Book of International Law (Vol. xxxiii, 1957), London, Oxford University Press, p. 2.

[9] George W. Ray, "Law Governing Contracts between States and Foreign Nationals", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), pp. 462-463.

The agreement establishes rights for each party and, at the same time, imposes obligations upon them within their respective spheres. Both parties have a hand in creating rights and in imposing obligations.

Considering the typical type of concession agreement, mineral or oil concession, a state usually offers two things as inducements for the contract:[10] first, the opportunity to search for the mineral or oil and, second, protection against interference in the search, development and enjoyments of the fruits of the enterprise. These considerations seem significant because they constitute important state support for the undertaking without which the expected rewards could be frustrated. It is upon these considerations that the concessionaire risks large sums of money and great effort. Protection of the concessionaire (company or individual) from interference in the discharge of its undertakings and in the enjoyment of the results of its efforts is admitted to be the essence of the state's contribution to the contract.[11]

Of course, the state's obligation to continue discharge of its undertakings is not an independent covenant. It is hinged to the performance by the company of its obligations to search for and develop or sale the resource and to return to the state an agreed share of the revenue. Earning such returns for the state is the essence of the company's contribution to the contract.

From what has been said hereinabove one can identify some important elements of concessions: the parities to the concession agreement are a state on the one hand, and

[10] Ibid., p. 463
[11] Ibid., p. 464

a foreign national (either individual or corporate) on the other; the concession is granted for a specified term of years; the agreements are entered into by a corporation of a nation having capital, skilled labor, and technical knowledge, with the government of a nation having natural resources needing development. These agreements are entered into for the purpose of developing these resources to the mutual benefit of the state and the concessionaire. George W. Ray considers concession agreement as a joint venture,[12] a venture in which the company will run the resource development, and the state will maintain the environment which will make the running of the business possible. This venture confers upon the company the right to carry out a long term enterprise in which both the state and the company have interest and from which both will benefit.

1.2 The Need for Concession Agreements

The foregoing section tells us that concession agreements may relate to different economic activities. As such they serve different purposes. But all those purposes can be expressed in a phrase-economic development. There is economic interdependence between states. The world from earliest times has been a picture of man's dependence on nature and his fellowmen. This dependence has necessitated collaboration. The truth that all the nations of the earth are members one with another in a family of nations is a concept which in our time has attained a reality. There is much which makes this a fact. The shriveling of the earth's surface by modern means of transportation and communication is one reason. There no longer is a far away corner of the earth.

[12] Ibid.

The growing respect of stronger nations for the rights of weaker countries is another. It is part of a maturing understanding of the inherent dignity of man and nations, wherever they may be found. The League of Nations in its day, and the United Nations today, are exemplications of the growing respect and understanding which has matured into international cooperation. There is the enlightened self-interest which has caused nations to help others with economic aid, with skills of various sorts, with individual techniques, and with a variety of humanitarian assistance.

The present state of world society is characterized by the coming into being of more and more nations and by unequal distribution of capital, industrial skill and resources. Therefore, today, George W. Ray submits, there is "a clamor among the old and the new for collaboration."[13] He reminds us not to forget that in the kind of world in which we live, states need one another, men need one another, states need men and men need states.[14] So do American scholars as they state, "No country can attain its development ends alone, economic interdependence is universal".[15]

As has been implied hereinabove it is the need for capital, skilled manpower and technology on the one hand and, on the other, the search for resources, market and generally more economic interest which makes states be involved in economic cooperation. These economic interests are well met through investment of capital and skill in a developing state and develop resources therein. We see that the interrelationship of human beings is a relationship of mutual interdependence.

---

[13] Ibid., p. 514

[14] George W. Ray, "The Development and Maintenance of an Oil Operation in the Middle East", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 1020.

[15] "Report of the International Committee on Nationalization of Property," Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 20.

International investment agreements, which are named by many as economic development agreements,[16] are good expression of these relationships to work for the benefits of the parties and for contributing to the welfare of mankind.

Governments alone are not signatories to agreements of this kind. Agreements have been and are being entered into between sovereign states and foreign corporations for the development of natural resources and provision of public utilities. It is submitted that a large part of direct investment is based upon a concession agreement:[17] upon international contract between the investing company and the government of foreign territory in which the alien makes investments. Lowell C. Wadmond states that world events have shown that foreign investment made in reliance upon concession agreements is vital to the economy of the world.[18] A view of the same nature is advanced by Lord McNair:

> *It is essential for the securing of more equitable level of material civilization that the citizens of the more advanced countries should engage in the process and receive a proper reward for their technical and financial assistance.*[19]

Concession agreements not only are fora to obtain promise of parties but also are the means to ensure that the promise will be performed. In other words, a concession agreement has the role of establishing the expectation that it will be carried out by the parties. The development of foreign investment through concession agreements has been accompanied by acquisition of rights such as ownership of property of alien

---

[16] McNair, Supra note 8, p. 2
[17] Lowell C. Wadmond, "The Sanctity of Contract between a Sovereign and a Foreign National", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 142.
[18] Ibid.
[19] McNair, Supra note 8, p. 2.

investors in foreign lands. It is obvious that this trend of foreign investment will continue, and it is essential that the host state should have a suitable legal environment.

It is plain that if there is to be economic progress the law must produce limits to the taking by state of alien property or property rights protected by contractual provisions. G.W. Ray admits that history has demonstrated this,[20] and Briggs states that we will have a world controlled by law or by force.[21] Obviously, if we are to have a world controlled by just law, the safer and more honorable course lies in the good faith performance by a party of its contractual obligations when the other party to the contract is ready and willing to do so, and the provision of adequate sanctions under law for failure of either party to so perform.

There is such a thing as an economics of dependability. A country which carries out its contractual obligations as expected creates a dependable environment for foreign investment. Ray's statement as to the findings of the study by the United Nations on the matter explains this:

> *It is being revealed beyond doubt that states which keep their promises have much less difficulty in finding those who are willing to help them develop their resources, than do states which are timid about guarantees of performance. The latter find that by their timidity they have created risks too great for investors to bear.*[22]

So, we see that concession agreements creating a common understanding that they will be performed play an important role inflow of foreign investment. It has been no

---

[20] Ray, Supra note 9, p. 516.
[21] Chalres W. Briggs, "The Cloudy Prospects for Peace through Law", cited in Ray, supra note 9, p. 516.
[22] Ray, Supra note 14, p. 1020.

accident that all over the world men and states have been permitted by law to make *ad hoc* law themselves in the form of contracts and that the contracts are binding.

1.3 The Problem

Determination of the legal status of concession agreements has proved to be a difficult task. A concession agreement is not a treaty, since one of the parties is a private individual or corporation. Nor is it simply a private contractual agreement, since the other party is a sovereign state.

It is a fact that much of the world's foreign investment is based upon a concession agreement made between an alien investor and the government of foreign territory in which the alien makes investments.[23] It is to this kind of agreement, one concluded between a government and a foreign national, that I invite attention.

The binding character of such international contracts concerns all of us. It has been aptly said that the emphasis in international life must shift from tort to contract.[24] That is why I should like to talk about the sanctity of contract between a sovereign and foreign national.

No one disputes the desirability of respect for and legality of agreements between states. Neither would there be dispute as to the desirability of respect for and the legality of contracts between individuals. The desirability of respect for and legality of contracts between a state and its citizens is also not subject to dispute. Equally, many

[23] Wadmond, Supra note 17, p. 142.
[24] Ibid., p. 141.

submit, there is no room for dispute over the desirability of respect for and legality of contracts between a state and a foreign private party. [25]

The problem is what law governs a concession agreement? Municipal law or international law? The question here is whether a state, as partner to a contract, by invoking its territorial sovereignty, has the right to contrive a legal situation which destroys or restricts the contract rights which that state had guaranteed in the contract to the other private contracting party. In other words, this is the problem of whether one party to a contract, namely the state, is justified solely because it is a sovereign state, in unilaterally altering or canceling the contract.

The opinions of writers on the legal position of concession agreements range from the view that the state contract is directly subject to the international law rule of *pacta sunt servanda* to the view that "contracts cannot be the subject of international disputes since international law contains no rules respecting their form and effect."[26] A conclusion was reached in the Anglo-Iranian Oil Company Case[27] that the concession agreement between Persia and Anglo-Iranian Oil Company was a contract governed by public international law. Jennings accepts the municipal law of the contracting state normally, to be the proper law of concession agreements.[28] From this assertion, that concession agreement is created in the local municipal law and subsists in that law, it follows that it may be terminated within that law.

---

[25] Ibid., p. 142.
[26] S. Friedman, Expropriation in International Law, Westport, Greenwood Press (1981), p. 156.
[27] "Anglo-Iranian Oil Company Case (1952), U. K. V. Iran", American Journal of International Law (Vol. 46, 1952), Washington, D. C., Lancaster Press Inc., p. 737.
[28] R. Y. Jennings, "State Contracts in International Law", The British Year Book of International Law (vol. xxxvii, 1961), London, Oxford University Press, p. 157.

The essence of my thesis is this: a contract, which the government concludes with a foreigner, is binding on both parties. It is binding under international law. My submission is that there is violation of international law where there is breach by the state of a contract with a foreign national. My submission is, further, that a breach is one in which the contracting state takes an action to defeat the expectations of the parties.

That a state should have such powers causes strong reaction. It is felt as a violation of the sense of justice that a state should unilaterally be able to cancel an undertaking given in the form of a contract.[29] The reasoning is that, if a contract is governed by international law, the non-fulfillment of the contract will be judged according to the principle of *pacta sunt servanda*, recognized in international law. And non-fulfillment thus becomes an international dispute. Relative to the legal consequences, the contract will be regarded as equivalent to treaty between two states. Non-fulfillment or cancellation of treaties and contracts will be assessed legally, in the same way. Concession agreements in all respects, it is submitted, are analogous to treaties and, therefore, like treaties, are governed by international law. [30]

This thesis, however, is not unchallenged. Sovereignty of states is at the center of the challenge. It is asserted that as a sovereign and as a law maker a state may alter the law it makes.[31] The sovereign must look to the general welfare of the people of whom it is the ruler. This is considered as giving a right to the sovereign to break the contract with an individual where it deems that the general interest requires to do so.[32] In other words, this is an argument that concessions are governed by municipal law. Since a

---

[29] Isi Foighel, Nationalization and Compensation, London, Stevens and Sons Limited (1964), p. 158.
[30] Ibid., p. 159.
[31] Wadmond, Supra note 17, p. 143.
[32] Ibid.

concession agreement is not an agreement between two sovereign states, under this theory, it can only be a private contract and hence can only be governed by municipal law.

These assertions of sovereignty, however they seem plausible, are unsound. The trend of law, national or international, is towards restricting the extreme manifestations of sovereignty, and towards strengthening the rights of the individual against the state.[33] This is to say that the sovereign immunity that states have enjoyed under international law has been narrowing. No doubt in treaty-making states limit their future freedom of action, and they are held to account for violation of agreements made therein. Such limitation incidental to right of entering into international engagements is held to be an affirmation, rather than a negation, of national sovereignty.[34] Lowell C. Wadmond submits that "the performance of the obligations of the state under its contracts is equally an attribute of state sovereignty. "[35]

Whether a state is allowed, under a legal regime that governs concession agreements, to interfere with contractual rights of an alien is the next problem worth consideration. A state's interference in the concession may take different forms: a state may fail to carry out what it promised to do, or a state might take the property of a party alien, or a state would introduce a law to terminate the concession in whole or to affect a certain right of the concessionaire therein. A form of interference which involves taking of the property of the alien most affects his right.

---

[33] Hearsch Lauterpacht, "The Problem of Jurisdictional Immunities of Foreign States", The British Year Book of International Law (vol. xxxviii, 1951), London, Oxford University Press, p. 221.
[34] Wadmond, Supra note 17, p. 144.
[35] Ibid.

It has been generally admitted that a state can take alien's property in its territory upon payment of compensation.[36] The right of a state to take any private property situated within its territorial jurisdiction is not disputed, for this is considered as an essential attribute of sovereignty.[37] Would the same apply to alien's property which a state by contract has covenanted not to take?

There is a view that property taking in defiance of contractual obligation is not contrary to international law. Because the same rules that apply to taking of property in the territory should apply to concessions, too. Foighel argues that the rule that nationalization is not a breach of international law cannot be altered by the fact that nationalization destroys contract rights.[38] For him there is no rule in international law that gives a greater degree of protection to rights secured by contract than to other rights of property.[39] O'Connell also declares that abrogation is legitimate because the state is concerned with the moral and economic welfare of its citizens, and it cannot bind itself to relationships with individuals that might in time derogate from that welfare.[40]

Arguments against the right of state to abrogate concession agreement have been put on several grounds. The most persuasive arguments for holding sovereigns internationally responsible for nationalization in breach of contract is based on the proposition of *pacta sunt servanda*. This principle states that states are bound to

---

[36] Brander, Legal Aspects of Foreign Investments (1958), cited in Leo T. Kissam and Edmond K. Leach, "Sovereign Expropriation of Property and Abrogation of Concession Contracts", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 398.
[37] Ibid.
[38] Foighel, Supra note 29, p. 193.
[39] Ibid.
[40] D. P. O'Connell, "A Critique of the Iranian Oil Litigation", International and Comparative Law Quarterly (vol. 4, 1955), London, The Society of Comparative Legislation, p. 267.

perform their treaties and to carry out in good faith the obligations assumed thereunder.[41] There is strong support for the proposition that this principle of intentional law also applies to contracts between states and foreign nationals. Even if the right of a state to nationalize alien property under its jurisdiction is unquestioned, by treaty or concession a state may, however, surrender or limit its right to nationalize.[42] Thus, nationalization which is "contrary to a state's undertaking is contrary to international law." [43]

The question of remedies in the event of abrogation of agreements has also been a source of discussion. Some argue that prompt, adequate and effective compensation should be paid if abrogation involves taking of property.[44] The method of computation of compensation and what constitutes prompt, adequate and effective compensation is subject to dispute. Others claim for restitution of property taken.[45] If the aim of international law is to discourage the unlawful violation of agreements, then requirements of restitution would, as rightly suggested, be the most effective means of attaining that objective. [46]

1.4 Scope of the Study

Study of the law applicable to concession agreements is in a way the study of the law of state responsibility in that respect: that the definition of the scope of this study would be better made from the point of view of state responsibility.

---

[41] Hans Wehberg, "Pacta Sunt Servanda", American Journal of International Law (Vol. 53, 1959), Washington, D.C., Lancaster Press Inc., p. 782.
[42] Kissam and Leach, Supra note 36, p. 399.
[43] Ibid., p. 398
[44] Ibid., p. 403
[45] Ibid.
[46] Ibid. p. 405

The subject is large and in many respects confused and uncertain. So it will be difficult to cover all the ramifications and qualifications. To keep the discussion within manageable size, limitations on its scope have been adopted. No relevance attaches, for present purpose, to those situations which attract the states' international responsibility, irrespective of whether or not the state is a contracting party. These are situations which are not specifically related to state contracts only. That they relate to concession agreements, among other things, is incidental. Such cases are generally governed by laws applicable to the state's tortuous liability. If the basis of liability of a state is tort, it extends to all contracts without regard to the type of contract or the identity of the contracting party. The specific type of state responsibility which is impliedly subject to investigation in relation to the problem at hand is, therefore, one which arises exclusively from a contractual relation between a state and a foreigner. For this purpose, a foreigner is one who has furnished capital or engaged in a course of business action within a foreign state in reliance on that state's promise in the contract.

More emphatically, the category of law to be investigated here is one which governs state's act which is objectionable because it encroaches upon a contract to which the state is a party. This, then, is the peculiar legal problem of state responsibility in relation to concession agreements. This is to see if a state's act, which in other cases would not cause liability, entails responsibility of a state in so far as it affects contracts made by the state with a foreigner. This means that a number of problems, which relate to the law of responsibility in general, are outside the scope of the study.

1.5 Assumption

The important assumption in this work is the supremacy of international law. Further assumed is the difference in standards between rules of national law and rules of international law, and that rules of international law are of higher standard, i.e., they afford better protection to interests in concession agreements.

The supremacy of international law over national law can be explained in different ways. For example, from the point of view of effect of this principle seems to have been established another rule that a state cannot escape international obligation by invoking its municipal law. Hence the Permanent Court's holding in the Free Zones of Upper Savoy Case that "... it is certain that France cannot rely on her own legislation to limit the scope of her international obligations..."[47] The Court held similarly in its opinion on Treatment of Polish Nationals in Danzig that "a state can not adduce as against another state its own constitution with a view to evading obligations incumbent upon it under international law..." [48]

No doubt an act of a state constitutes a sovereign act. But to state that no sovereign act of a government affecting foreign national is open to question, as to its validity under international law, is to say that states are not subject to international law. But as indicated in the hereinabove cited cases sovereign act is no defense to an obligation in international law. For example, the obligation of a state imposed by international law to pay compensation at the time of taking of alien's property cannot be abrogated by local legislation. If the contrary were true, states seeking to avoid the necessity of making

[47] Quoted in "Report of the Committee on Nationalization of property", Supra note 15, p. 23.
[48] Ibid.

compensation could avoid such responsibility simply by changing their local law. Every international obligation could thus be wiped off the books. But international law cannot thus be flouted. Membership in the family of nations imposes international obligations. In short, it is to the standards of international law that states, in their treatment of alien property interests, must adhere.

CHAPTER TWO

STATUS OF CONCESSION AGREEMENTS

2.1 Position of Parties

If fruitful collaboration between the developing countries and foreign enterprises is to be established, there must exist an atmosphere of trust. It is necessary that the system should offer the developing countries the guarantees they may rightfully expect. It is equally necessary that the foreign enterprises which provide capital and technical resources should be protected against certain risks to which the attitude of their contractors could expose them. It is only insofar as both parties find adequate guarantees in their association that it will lead to happy results. This is possible when the parties involved are equally treated in application and interpretation of the agreement.

True, the contracting parties to a concession agreement are of different quality since one is a state and the other a private corporation. The question is if the inequality of parties should follow from such difference. The sovereign quality of the state, some submit, introduces a fundamental disparity in to the relative positions of the parties.[1] The idea is that though one of the parties is a private person or corporation, the other is a state acting in a sovereign capacity, since it undertakes obligations with respect to its sovereign powers, i.e., powers which are essential to it for the protection of its people. It is presumably for the interest of its people that the government is acting in encouraging foreign investment.

---

[1] Michael D. Ramsey, "Acts of State of Foreign Sovereign Obligations", Harvard International Law Journal (Vol. 39, 1998), p. 24.

Here it is claimed that the sovereign power of a state cannot be subjected to contract.[2] A sovereign state cannot limit its power by making contracts binding on it; that sovereign power always takes precedence over contractual promises. In other words, establishment of superiority of contract would be an improper limitation of sovereignty.

According to this view, whatever a state does in its sovereign capacity cannot be called in question, for the state is answerable to no other authority for its actions.[3] One of the reflections of this attitude is found in the pronouncement of the government of Iran. At the time of nationalization of the Anglo-Iranian Oil Company the Iranian Minister of Finance made a statement to the effect that the fact of nationalization of a foreign industry, which derives from the exercise of sovereign power, is not subject to examination by any international authority.[4]

The explanation of precedence of sovereignty over contract is two-fold. First, in a phrase that has become known as the "unmistakability" doctrine, it is said that sovereign power governs all contracts and will remain intact unless surrendered in unmistakable terms.[5] Second, it has been suggested that a sovereign may not, in any event, contract away an essential attribute of its sovereignty.[6] Both doctrines respond to the view that the ability to act in the public interest is a critical attribute of sovereignty. The first limitation requires that any surrender of power should not be found by implication. The second suggests that such surrender will not be recognized, even if

---

[2] Leo T. Kissam and Edmond K. Leach, "Sovereign Expropriation of property and Abrogation of Concession Contracts", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 377.
[3] Richard Young, "Remedies of Private Claimants Against Foreign States", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 908.
[4] Ibid.
[5] Ramsey, Supra note 1, p. 23.
[6] Ibid., p. 24

plainly intended. The unmistakability doctrine is a rule of contract interpretation that requires a contractual limitation on sovereign power to be unambiguously stated. The argument is that because sovereign power is of great importance to the government, one should not assume that in entering into a contract the government bound itself not to exercise it.

The second aspect of rule of sovereignty – that certain sovereign powers cannot be surrendered by contract even if the intent to do so is unmistakable-seems of greater concern with respect to the position of the parties. This view arises from the sovereign's role as promoter and protector of interests of its citizens. It is submitted that the sovereign should not be permitted to give up its ability to act in the public interest.[7] The view is that certain powers are so often necessary for the proper performance of governmental functions that the power is deemed to be essential to the life of the state.[8]

Others try to justify this view from the point of view of economic sovereignty. They argue that permanent sovereignty over natural resources constitutes *jus cogens,* which a state cannot waive by agreement.[9] This is to say that a state shall not limit by agreement its power over natural resources, or such limit remains to be mere attempt and will be set aside at the state's will.

In line with the foregoing views Fatouros states that the contractual freedom of a state is limited, as the content of the promises to be granted are provided for in, and therefore,

---

[7] Ibid.
[8] The powers that are subject to this doctrine remain ill-defined.
[9] Thomas W. Waelde and George Ndi, "Stabilizing International Investment Commitments: International Law Versus Contract Interpretation", Texas International Law Journal (vol. 31, 1996), Texas, Austin School of Law Publications Inc., p. 240.

limited by, preexisting legislation.[10] Hence, the state cannot commit itself with respect to matters on which it has no authority so to do.

These arguments tend to place the parties to the kind of agreement we are talking on unequal footing. The idea of implied reservation of sovereignty puts a state in relatively superior position, that a state's right in addition to the terms of the contract, emanate from its sovereignty while the clear terms of the contract are the only sources of rights of the foreign contractor.

Opposite to the foregoing view is the theory that a state should have no prerogatives beyond those of private individuals. Maurice Bourquin submits that association of the contracting parties places them on the same footing; that their association is one in which the equality of the parties is the rule.[11] The idea here is that the very nature of concession agreements requires that the two contracting parties be placed on exactly the same footing as to the obligations to which they have subscribed. The obligations of a state must be as fully and as rigorously respected as those of the foreign contractor. Sovereign power of a state introduces no exception to this rule.

The need for certainty as to the legal effect of the parties' relations seems at the center of Bourquin's claim for equality. This is clear form his statement:[12]

---

[10] A.A. Fatouros, Government Guarantees to Foreign Investors, New York, Columbia University Press (1962), p. 195.
[11] Maurice Bourquin, "Arbitration and Economic Development Agreements", Business Lawyer (Vol. 15, 1960), Chicago, Banking and Business Law of the American Bar Association, p. 862.
[12] Ibid., p. 864.

> *... it is indispensable that agreements of this type guarantee to both parties not only a real equality of treatment but also a certainty as perfect as possible as to the legal regime of their collaboration and the protection which it affords. And the theory of the implicit reserve of sovereignty inevitably weakens this certainty and introduces into the system an element of imprecision which may react dangerously on the balance of the interest involved.*

These statements make it clear that the theory of the implicit reservation of sovereignty is inapplicable in the case of concession agreements. This requires a state to make it clear in the contract itself if the protection of public interest which it has to ensure makes it necessary to reserve certain powers. Once the agreement is signed, the parties are placed in similar positions in that their rights depend only on the terms of the contract.

For Thomas W. Waelde and George Ndi, too, it is the consensual nature of the concession agreement which makes it impossible for a state to exercise a privilege which it is not given in the contract.[13] Their view is that concluding concession agreements results in "pulling the state down from its sovereign pedestal, replete with powers of commands, to a level of equality..."[14] They further claim that characterization of principle of permanent sovereignty over natural resources as a *jus cogens* rule is based on excessive and untenable notion of absolute sovereignty.[15]

The state is certainly the guardian of the safety and welfare of its people. The state is expected to act in the interest of its people. Concluding concession agreements which go against public interest, therefore, amounts action without authority. This may be considered as a sort of limitation on state power to contract.

---

[13] Waelde and Ndi, Supra note 9, p. 234.
[14] Ibid.
[15] Ibid., p. 252.

2.2 The Governing Law

No concession agreement exists in a legal vacuum. The agreement draws its binding force and its effectiveness from a certain legal system which should be capable of dealing with problems of performance and violation. The nature of concession agreements requires that such system of law should be able to bring about a balanced equilibrium permitting a harmonious reconciliation between two interests:

(i) the legitimate expectations of the foreign investor which calls for maintaining the contract untouched during its entire long term period; and

(ii) the requirements of national development in– host countries which want to exercise sovereign rights on their natural resources.

What that system of law is is subject to controversy. There is no general agreement on the type of law applicable to concession agreements. Writers, states and international tribunals differ in their views on the law in effect. The difference of opinion extends both to the *lex lata*, the legal rules held as effective, and to the *lex ferenda*, the law which ought to exist. The controversies, far from being merely theoretical disputes, are of real practical importance and have far-reaching effects on relations of parties to the agreement under consideration.

Those controversies may be grouped into three different views on the law applicable to concession agreements. The first of these holds that the system of law which has been selected by the parties is the proper law of the contract.[16] The law elected by the parties

[16] Lovis B. Sohn and R. R. Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 995

to an agreement between a state and an alien may be the municipal law of the contracting state, the law of some other state or international law.

The second one treats a concession as being governed exclusively by the municipal law of the contracting state, even though the contract evoked some other legal system as the proper law of the contract.[17] According to this view, the validity of the choice of some other system of law as the proper law of the contract shall be determined by the municipal law of the contracting state as that law may provide from time to time. The alien contractor would be left defenseless against modification or termination of the contract by the state. The state's obligation remains illusory if it is allowed to alter the terms or to affect the effectiveness of the contract at its will through its executive or legislative action. Investment relations between states and aliens will be discouraged if the former is left at liberty to perform or not to perform its promises.

The opposite extreme to the second view would be to test the conduct of parties to the contract by international standard, not withstanding any choice of law which the parties might have incorporated in the agreement. This would, in effect, raise concession agreements to the status of international agreements between states. Sohn and Baxter argue that subjecting concession agreements to international standards discourages, as in the case of the foregoing view, investment relations.[18] This seems because if concessions were to bind states in every instance as firmly as international agreements, states might be reluctant to enter into contractual relations with aliens.

[17] Ibid., p. 996
[18] Ibid., p. 995

2.2.1 Contract as a Comprehensive Regime

The nature of concession agreements is described in the foregoing chapter. These contracts evolve from agreements between a state and a foreigner (individual or company). Schwarzenberger describes these contracts as "quasi-international agreements."[19] They are neither contracts concluded between parties which are subject to a municipal law, nor are they concluded between parties subject to international law. As such it is submitted that relations of parties to concession agreements are governed by an independent legal order created by the common will of the parties.[20]

Professor Verdross, thereby concurring with Schwarzenberger, proposes that concession agreements need not be controlled by existing legal systems, that there is nothing to prevent these agreements from creating their own legal system.[21] The idea is that the intent of the contracting parties determines what rule or body of law governs the contract. For example, the parties could intend that international law or municipal law of one or another state governs the contract. The intent may be manifest either by express contractual clause or inferred from circumstances.

Looking for the law to be applied by tribunals addressing disputes relating to development agreements Maurice Bourquin holds the view that these rules will have to be discovered in the contract itself.[22] For him a concession agreement does not rest on a juridical order independent from its own clauses, the contract forms, by itself, the law

---

[19] Schwarzenberger, International Law as Applied by International Courts and Tribunals (1957), Cited in Isi Foighel, Nationalization and Compensation, London, Stevens and Sons Limited (1964), p. 167.
[20] Ibid.
[21] Alfred Verdross, "The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses", Selected Readings on protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 125.
[22] Bourquin, Supra note 11, p. 868

of the parties. The rights and obligations of parties are governed by "a new legal order created by contracting wills of the parties".[23] It is to the contract that arbitrators will have to refer. The view is that the contract must furnish all necessary indications.

These views tend to insulate concession agreements from the operation of the law of the host state by considering the agreement as an independent and self-sufficient system of law regulating the entire range of relations between the parties. In effect the agreement creates a separate, self-contained and coherent body of legal principles which exclusively governs relations between the host state and a foreigner. These arguments emphasize the completeness of concession agreements to contain provisions to address all possible disputes. Verdross maintains that in practice these kinds of agreements always contain detailed provisions which must be applied when disputes arise between parties.[24]

Ray, a specialist in international transactions, also emphasizes on self-sufficiency of these transactions as he asserts that:

> *At the time of initial negotiation of the agreement the representatives of both parties readily concede that the agreement itself is the source to which the parties should go for the ascertainment of their respective rights and obligations to one another.*[25]

He goes on further saying:

> *... the agreement itself should be, and it is, the ad hoc law by which the state's rights against the company, the company's rights against the state, and the obligations of each to the other should be determined.*[26]

---

[23] Verdross, Supra note 21, p. 121.
[24] Ibid.
[25] George W. Ray, "Law Governing Contracts between States and Foreign Nationals", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 466.
[26] Ibid.

These assertions accept that parties to each agreement endeavor to prepare a kind of constitution by which their relationship will be regulated. As the agreement is sufficient within itself there is no necessity for looking beyond its terms to ascertain the rights and obligations of the parties. The agreement provides the means of ascertaining a breach of the contract and corresponding remedy.

Carlston describes a concession agreement as a "constitutive or organic instrument for an organization of international economic relations."[27] The contention that concession agreements provide for a source of rules regulating relations of parties thereto is also maintained by Lord McNair as he states that:

> *An entirely adequate basis for the choice by tribunals of an appropriate system can be found in the intention of the parties, manifested either by express provision in their contract, as sometimes happens, or by implication from the terms of the contract and the nature of the transaction envisaged by it.* [28]

We have seen here-in-above that many of the best writers have concluded that concession agreements are by their nature regarded as the *ad hoc* law of the parties. These agreements are considered to be complete within themselves or within a legal system set out in the agreement itself. The right to make contracts and to make them almost all-inclusive seems to have become an important part of the sanctity of contract since it is from this freedom that the contracting parties get the right to select the law which shall be applicable to their contract.

---

[27] Kenneth S. Carlston, "International Role of Concession Agreements", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 247.

[28] Q. C. McNair, "The General Principles of Law Recognized by Civilized Nations", The British Year Book of International Law (vol. xxxiii, 1957), London, Oxford University Press, p. 5.

It was shown in the foregoing paragraphs that rights and duties, stemming from concession agreements, have to be construed according to the *lex contractus*. Sometimes it may be difficult for the parties to stipulate in the contract in exhaustive detail every legal situation that would possibly arise between them. They take care of this problem by including in the contract express or implied clauses determining the law applicable to disputes between the parties.[29] This is to say that the concession agreement may, as to the law applicable, make reference to any of the existing legal systems. Verdross states that such reference may relate to municipal law of parties, general principles of law, international law or merely *bona fide* application of the agreement.[30] He also mentions some agreements in which reference is made partly to municipal law and partly to *bona fides*. [31]

True, the contract may foresee that one or the other aspect of relations between the parties will be governed by a certain legal system. It is also clear that the competence of such legal order results from the concordant wills of the parties. Therefore, such incorporation of a legal system to a contract does not still contradict the principle we have been talking, that the contract itself constitutes, exclusively, the law of the parties. A reference in the contract to a legal system does not alter the fact that it is *lex centractus* which is applied formally. So, Verdross' assertion that *lex contractus* can call on the municipal law of the parties, general legal principles, international law, good faith and reasonable interpretation or combination of these legal rules is in line with the principle.

---

[29] Foighel, supra note 19, p. 168
[30] Verdross, supra note 21, pp. 128-129.
[31] Ibid., p. 129

Nevertheless, Bourquin submits however carefully the parties may have stated their intentions, they may fail to express every case explicitly and precisely.[32] Verdross also cites agreements which do not contain express provisions determining the applicable law.[33] Bourquin maintains that concession agreement, "Whatever its nature, must necessarily be incomplete," and that this gap must be filled by "what may reasonably be considered as implicitly admitted by the contracting parties."[34] The same view is held by Foighel as the suggests that the arbitration tribunal may select the law to be applied, "having regard that the agreements in question were concluded *inter pares*", when there exists no clear indication of the applicable law.[35]

The common element in these assertions is that in the absence of contractual stipulation on a matter the applicable rule shall be found in the implied intention of parties, which is to be determined on the basis of the nature of the agreement. Verdross admits these implied rules to be general principles of law as he says:

> *... the arbitral tribunal must interpret the agreement according to such general principles of law as the parties have or can by reasonable inference be presumed to have presupposed in concluding an agreement inter pares.*[36]

For Foighel, however, the selection of one or another applicable law in case of silence depends on the kind of the question at hand.[37] Hence it is not necessary that the agreement relates only to a single system of law, it is possible that some matters are governed by one system of law and other matters by another system of law. It all

---

[32] Bourquin, supra note 11, p. 868
[33] Verdross, supra note 21, p. 129.
[34] Bourquin, supra note 11, p. 868
[35] Foighel, supra note 19, p. 168
[36] Verdross, supra note 21, p. 129
[37] Foighel, supra note 19, p. 168

depends on the very nature of the individual matter.[38] The decisive criterion as to whether a dispute on the interpretation or fulfillment of a concession agreement falls within international law or municipal law must consequently be the character of the dispute. It is maintained that the interests or expectations of parties or preconditions of the contract shall in turn be depended on to identify the nature of the dispute for the purpose of subjecting it to one or another system of law.[39] It follows that if the dispute is of such a kind that interest and expectations of the parties are met by applying municipal law of either party, then such municipal law will be the proper law of the contract with respect to that specific question. However, if the dispute is of a kind which makes a solution in accordance with the municipal legal system of the parties meaningless, then the solution must be in accordance with international law.

In short, this principle requires one to refer to the character of a specific question to identify the applicable law for it in case the contract is silent on the matter. If characterization of a dispute is to depend on the expectation or interest of parties, the principle seems to add nothing new to the implied choice of law doctrine. Because it is having regard to their expectations and interests that the implied intention of parties can be inferred.

The theory which we have been considering deeply in this section, that concession agreements are founded on an independent legal order, namely the *lex contractus* of parties, which regulates exhaustively their relations, is objected on different grounds. Asante asserts that the theory "is dismissed as patently untenable on the grounds that the validity of every agreement must itself be derived from some external legal order-be

[38] What questions fall within each legal system is left unanswered.
[39] Foighel, supra note 19, p. 173.

it international or municipal."[40] Mann also tries to show that contracts have to be based on some existing legal system is a generally accepted principle.[41] Fatouros rightly invokes a practical problem that most problems or disputes relating contractual provisions are not by themselves clear and have to be understood in accordance with some legal system.[42] To say that parties had better make their intentions clear in the contract thereby making the latter self-sufficient is one thing, and to say that all contracts are actually self-sufficient is a different one. Clear indication of wishes of parties in the contract would enable one to give effect to their right intentions. But to deny the possibility of many incomplete agreements is impractical. An aspect of a relationship which was not expected at the time of making to be the point of contention might subsequently emerge as a matter of dispute. This dispute shall be solved on the basis of some legal system. Verdross accepts this legal system partly to be the general principles of law as he maintains that the reason of validity of these agreements exists not in municipal or international law but "in the general principle of law *pacta sunt servanda*", which principle, it is assumed, is recognized by parties at the time of entering into the agreement.[43] At the same time he argues that an agreement need not depend on any other legal system, it may itself create a legal community. [44]

2.2.2 National Law

The question of what law governs concession agreements has been answered in different ways. One answer, which will be discussed in this sub-section, is that

---

[40] Samuel K. B. Asante, "Stability of Contractual Relations in the Transnational Investment Process", Third World Attitudes Toward International Law-An Introduction, Boston, Martinus Nijhoff Publishers (1987), p. 698.
[41] F.A. Mann, "The Proper Law of Contracts Concluded by International Persons", The British Year Book of International Law (vol. xxxv, 1960), London, Oxford University Press, pp. 48-50.
[42] Fatouros, supra note 10, p. 286.
[43] Verdross, supra note 21, p. 129.
[44] Ibid., p. 121.

concessions are governed by municipal law. The contention in this view is that there are two kinds of law-international law and municipal law, and that international law governs relationships between states only while all other relationships are governed by municipal law.[45] It follows under this theory that since a concession agreement is not an agreement between sovereign states, it can only be governed by municipal law.

The view is advocated by renowned writers. In the absence of contrary intention of the parties a concession is, Schwarzenberger contends, subject to the municipal law of the grantor.[46] Likewise, Foighel argues that whether a state maintains its obligation in a concession shall be determined on the basis of municipal law and not international law.[47] The view in these contentions seems to have been influenced by the afore said dogma that international law is solely a legal system which governs relations between states, and thus every legal situation where one party is not a state is to be referred to municipal law.

The idea is that a transaction to which one of the parties (an alien) is not the subject of international law cannot be the subject matter of international law.[48] The procedural incapacity of the individual that he/she cannot bring his claim by his own before international tribunals adds another point.[49] Implied in this contention is that the legal situation will completely be changed that the legal basis passes to international law if

[45] Kissam and Leach, supra note 2, p. 379.
[46] Schwarzenberger, The Protection of British Property Abroad (1952), cited in Kissam and Leach, supra note 2, p. 379.
[47] Foighel, Nationalization (1957), cited in Kissam and Leach, supra note 2, p. 379.
[48] For many individual values have been recognized by international law, this view does not seem to hold always.
[49] Still the fact that individuals are being given capacity to litigate before some international human rights courts should not be forgotten.

the home state of the private person takes up the case against the contracting state. Examination of Fischer Williams' assertion in relation to state loans reveals the same: [50]

> *When the debt is from state to state, we have at once a relationship within the sphere of international law... where the contract from which the debt arises is between a state and a foreign individual, the matter becomes one of international law in the strict sense only if and when the state of the individual makes his cause its own and addresses itself diplomatically to the contracting state.*

The Anglo-Iranian Oil Company Case[51] where the International Court of Justice clearly rejected the view that the concession concluded between the Company and Iran was of the nature of a treaty may also be cited in this connection.

International law normally concerns itself, it is submitted, with "the questions of whether the means of redress are afforded in the state and if so how these means are effectuated by organs of the state."[52] It is the right of redress and the methods by which it is given effect that are within the competence of international law. Substantive rights and obligations connected with the contract remain to be matters of municipal law. Amerasinghe considers this to be the possible way to reconcile the interests of contracting states and aliens.[53]

This view of subjecting concession agreements of the type under discussion to municipal law has been described by the American Branch of International law Association as unsound:[54]

---

[50] Fisher Williams, Chapters on Current International law and the League of Nations (1929), quoted in Foighel, supra note 19, p. 163.
[51] The I.C. J. Report (1952), cited in Foighel, Supra note 19, p. 163.
[52] C. F. Amerasinghe, State Responsibility for Injuries to Aliens, Oxford, Oxford University Press (1967), p. 69.
[53] Ibid.
[54] 1957 – 58 Proceedings and Committee Reports of the American Branch of the International law Association, quoted in F.A. Mann, "State Contracts and State Responsibility", American Journal of International Law (Vol. 54, 1960), American Society of International law, New York, p. 582.

> *The unsoundness of treating the legal rights arising from contracts between states and aliens as being of a lower order than those arising from agreements between governments or their agencies merits further illustration. Afghanistan recently granted the Soviet Techno Export Organization rights to explore for oil in Afghanistan. A breach by Afghanistan of the pertinent agreement would be a breach of international law. But a contract with privately owned oil company, for the same object, of the same substance, upon the same object, of the same substance, upon the same terms, breached in the same way, by the same state, would not be a breach of international law in the eyes of some formalists.*

The view that national law is governing law of concessions is also founded on another ground, that rules relating formation and effect of concession agreements are to be found in national law. Friedman says, "contracts cannot be the subject of international disputes since international law contains no rules respecting their form and legal effect."[55] Amerasinghe also doubts that a breach of a concession agreement is *per se* a breach of international law, for "it is not clear that international law does, in general, have substantive provisions relating to the form and effect of contracts between states and individuals as such."[56] He, therefore, implicitly seems to accept applicability of municipal law to relations from concession agreements.

Ray makes an assumption that concessions are made within a state party, and submits that no activity outside the state's boarder is required for implementation of those agreements.[57] It, therefore, follows that these agreements depend for their validity, and also for their interpretation, upon the law of the state. According to Ray, this holds true in the absence of an expressed or implied contrary intent.[58]

---

[55] S. Friedman, Expropriation in International Law, Westport, Greenwood press (1981), p. 156.
[56] Amerasinghe, supra note 52, pp. 68-69.
[57] Ray, supra note 25, p. 461.
[58] Ibid.

The idea here is that concession agreement is created and subsists in the municipal law of a state. And it follows that it may be terminated by the state legislation, and this does not amount to breach of the agreement. This is also what Dr. Mann holds in his statement that: [59]

> *Contracts are governed by the law determined by the private international law of the forum. That law not merely sustains because it sustains, may also modify or dissolve the contractual bond.*

It is suggested that "there cannot in the juridical nature of things be any question of claim on the contract arising at international law" where the agreement is governed by municipal law as its proper law.[60] The contract nexus is thus regarded as a closed system within its own proper law. There can be no breach of contract where the contracting state has ended the agreement by change in the local law. There cannot be any international law remedy for such act of state because there is no breach of agreement.

The extreme position in favour of national law asserts that concessions are governed strictly by municipal law. The position is based on the assumption that an alien by mere fact of entering into the agreement concedes to be bound by municipal law of a state party. It is as such submitted that by concluding a concession agreement with the state, "the foreign national has shown his respect for and confidence in the latter and has consequently accepted the obligation of submitting to its judicial organs."[61] Amerasinghe firmly believes that it is reasonable to expect that any ordinary businessman entering into a concession agreement is aware of and accepts the law of

---

[59] Mann, supra note 54, p. 581.
[60] R. Y. Jennings, "State Contracts in International Law", The British Year Book of International Law (vol. xxxvii, 1961), London, Oxford University Press, p. 162.
[61] Friedman, supra note 55, pp. 157 – 58.

a state party.[62] Consent to enter into a transaction is equally considered as consent to the application of laws of the state to that transaction. The free choice of one involves the free choice of the other. As such the alien is deemed to accept laws of the state relating both to validity of the agreement and to remedy in case of its breach. He is expected to accept the risk of breach of the agreement as well as whatever mode of redress therein. Therefore, he cannot expect that provisions different from state's law, such as any that international law may provide, be applied to his claim.

The Second Report by Garcia – Amador, Special Raporteur on International Responsibility to the International Law Commission, States:[63]

> *Learned opinion and practice are agreed that contracts made between the government of a state and an alien are governed, so far as their conclusion and performance are concerned, by municipal law of the state and not by (public) international law, for a private person who enters into a contract with a foreign government ipso facto agrees to be bound by the local law with respect to all the legal consequences which may flow from that contract.*

Mann submits that there is no doubt and it is well established through practice of highest tribunals that the proper law governs concession agreements "as it exists from time to time."[64] He adds that this holds true even when it is agreed that the agreement is subject to the proper law as existing at the time of making of the contract, thereby excluding subsequent changes.[65] If, therefore, a sate relies on changes in its law, it cannot be held liable for breach of contract through change of its law. In his *de lege ferenda* argument Mann, however, suggests that the state shall be liable for breach of the agreement if this results from enactment of new law after the conclusion of the

---

[62] Amerasinghe, supra note 52, p. 68.
[63] Garcia – Amador, Second Report to International Law Commission on International Responsibility (1957), quoted in Kissam and Leach, supra note 2, pp. 379 – 80.
[64] Mann, supra note 54, p. 581.
[65] Ibid.

agreement.[66] In this respect, he proposes a higher standard against which a state's conduct is tested.

On the other hand, Jennings asserts that *de lege leta* international law has nothing "that inhibits the recognition of international law remedies which relate directly to contract."[67] Both Mann[68] and Jennings[69] in their respective *de lege ferenda* and *de lege leta* arguments do not, in fact, deny the existence of situations in which a state may be entitled to change the law to the detriment of the alien contractor.

Dr. Mann identifies a *de lege leta* situation in which an alien contractor may be protected against legislative encroachments by the state. This is when he obtains a consent that the agreement be submitted to a legal system other than that of the contracting state.[70] Even in case of submission by the alien of the contract to the municipal law of the state as it exists form time to time, there is a practical ground, Mann suggests, for protection of the alien.[71] The idea is that in practice an alien has no choice but to concede to the municipal law application. This is not a free concession, and it, for the purpose of justice, requires that any state legislation affecting the contractual interest of the alien be denied international validity. This seems to have been regarded as conforming to practical needs.

The otherwise assumption may put this practical argument in question. A concession agreement is the means of importing capital and skill to the needy developing states. It

---

[66] Ibid., p. 591.
[67] Jennings, supra note 60, p. 181.
[68] Mann, supra note 54, p. 591. According to him, these situations shall relate to protection of public safety, health, morality or welfare in general.
[69] Jennings, supra note 60, p. 182. For him the definition of these situations must itself be a question of international law.
[70] Mann, supra note 54, p. 588.
[71] Ibid.

may be said hat these states which cannot meet the needs of their subjects and which are in need of progressive development have no choice but to accept all the terms proposed by the alien contractor. This shows that the practical need is in a different direction than proposed by Mann.

Assumption of mutual interdependence between developed and developing states seems better understanding of the reality. There are many instances in which both developed and developing ones need each other for development. So, freedom of choice shall be the basis to give effect to the parties' intention.

Here it is worth mentioning one more variety of nationalist views, i.e., the existence of the Calvo Clause[72] in the concession agreement. The Calvo Clause is a contractual clause by which the alien submits himself "to the local jurisdiction to such an extent as to preclude his state from extending him diplomatic protection."[73] This doctrine, that a concession agreement containing Calvo Clause is subject to municipal law, originated in Latin American States and is shared by other developing states.[74]

The Calvo Doctrine excludes international control over foreign investment agreements and subjects them to national control. It requires that disputes arising from concession agreements be settled by national courts. The purpose is to put aliens on the same footing as nationals of the sate. This is to bar aliens form protection by their home government.

---

[72] It took the name after the Argentine author.
[73] Kenneth S. Carlston, "Universality of International Law Today: Challenge and Response", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 14.
[74] Ibid., pp 13-14.

The Calvo Doctrine clearly speaks that obligations can be curtailed by the operation of a clause in the agreement. Equally the doctrine assumes the possibility of an international law of concession agreement. This assumption is in contradistinction with the extreme view that concessions, being made within a state, are governed strictly by municipal law.

The extent of validity of a Calvo Clause is open to dispute. As contended by Argentine author of the Doctrine and governments and scholars following his view, the clause is fully binding.[75] The view is that by Calvo Clause the alien does away with the possibility of intervention by his home state at whatever instance. This includes renouncing his rights in property which he could have enjoyed by direct application of rules of international law, and which could have been enforced through intervention of his home state.

On the other hand, Richard Young argues that the binding force of the Calvo Clause is limited in some respects. The existence of the Calvo clause, he maintains, shall not preclude the intervention by home state and the appeal to international standards when, for example, "the local remedies offered prove to be illusory" or if these remedies are "bared or corrupt as to cause a manifest denial of justice."[76] He further contends that a private party cannot by agreement waive the right of his home state to intervene when its own interest is involved.[77] The point here is that the state is not acting as agent of its national in advancing its own claim, and that an individual has no power to determine the authority of the state.

---

[75] Young, supra note 3, p. 922.
[76] Ibid., p. 923.
[77] Ibid. (Public interest may demand the prosecution of the individual's claim regardless of his own wishes or promises).

Conceding with the holdings of many arbitral tribunals that the Calvo Clause cannot prevent an alien from subsequently making a claim he has in international law, Lauterpacht, however, states that this does not apply to acts of interference to property. This is clear in the following paragraph:[78]

> *It is true that as laid down in a number of arbitral decisions, the Calvo Clause cannot be used for anticipatory acquiescence in treatment clearly contrary to international law. It does not necessarily follow that, in the matter of compensation for deprivation of or interference with property, aliens cannot in advance agree to be treated on the same footing as nationals.*

Sornarajah seems to argue for application of the Calvo Clause to the fullest extent as he questions precedence of diplomatic protection over state sovereignty in situations "where renunciation of diplomatic protection may have been a condition for permitting the entry of foreign investment."[79] He adds that the Calvo Doctrine itself is the assertion of international law principle of state sovereignty over matters within its jurisdiction. [80]

True, there has been developments in international plane giving more and more power of sovereignty for a state over its resources. Resolutions on the New International Economic Order and the Charter of Economic Rights and Duties of States are only few among these. There are several resolutions on principle of permanent sovereignty over natural resources. Sornarajah asserts that this development is able to bring about a situation in which the Calvo Clause becomes an implied clause in every concession agreement.[81]

---

[78] Hearsch Lauterpacht, Collected Papers (1977), quoted in M. Sornarajah, The Pursuit of Nationalized Property, Dordrecht, Martinus Nijhoff Publishes (1986), p. 136.
[79] Sornarajah, supra note 78, p. 136.
[80] Ibid.
[81] Ibid., p. 137.

The problem of the law of concessions has been the subject of discussion in international fora. Particularly, many UN resolutions on state sovereignty over natural resources embody provisions directly or indirectly relating to investment agreements. The most important of these expressly addressing the alien-state contractual relationship is Resolution on Permanent Sovereignty Over Natural Resources (Resolution 1803 (XVII) of 14 December 1962). Its significance lies in the fact that it received the support of both capital exporting and capital importing states.[82] The Resolution affirmed the principle of permanent sovereignty over natural resources and the primacy of national legislation in dealing with it (sections 2,3). It also requires that "foreign investment agreements freely entered into by, or between, sovereign states shall be observed in good faith." (section 8).

These statements seem to give rise to inconsistency within the Resolution. On the one hand, capital importing states tend to generalize that state sovereignty includes its power to take any measure over any wealth in its territory. On the other hand, capital exporting states hold the view that agreements between an alien and a state should be respected. By some scholars the Resolution is seen as representing a compromise between the interests of developing countries in the protection of their rights over their resources and those of the developed countries in securing adequate guarantees for foreign investors.[83]

Examination of the legislative history of section 8 of the Resolution reveals the dispute that existed between these two groups of states. The proposed provision by U.S.A. and UK. on the point under discussion reads: "Foreign investment and technical assistance

[82] It was passed by eighty seven to two, with twelve abstentions
[83] Sornarajah, supra note 78, p. 121.

agreements freely entered into by sovereign states shall be observed in good faith."[84] The phrase "by sovereign states" was intended to refer both to agreements between states and between a state and an alien. And this was objected by developing countries. Iraq contended that agreements between states and aliens were to be protected by national legislation, and that it was not necessary to mention these agreements in international instrument.[85] Lebanon and Syria joined Iraq, and, accordingly, moved for replacement of "by sovereign states" with "between sovereign states" in the proposed provision.[86] The view of the developing countries is clear, that agreements entered into between sovereign states and aliens should not be subject to international jurisdiction. The motion for such replacement was, however, defeated by a majority vote, and the U.S-U.K proposition was then adopted. [87]

Even after the adoption of the Resolution countries continued to interpret the provision in their own favour. The understanding of Iraq was that the Resolution regarded agreements signed between aliens and states as simple contracts governed by domestic law.[88] On the other hand, developed countries understood the resolution as giving international protection for those agreements. This is clear from the statement of U.S. representative:[89]

> *My delegation is specially gratified that this conference has affirmed the binding character of foreign investment agreements... whether these agreements are concluded between states... or between states and private foreign investors.*

---

[84] Quoted in Stephen M. Schwebel, "The Story of the United Nation's Declaration on Permanent Sovereignty Over Natural Resources", Selected Readings on Protection by Law of Private Foreign Investment, Texas, Mathew Bender and Company (1964), p. 711.
[85] Schwebel, supra note 84, p. 711
[86] Ibid., p. 712
[87] Ibid.
[88] Ibid.
[89] Ibid., p. 713

All these show that the view of the international community was divided on the problem of status of concession agreements. One more thing is also clear, that the debates preceding the adoption of the Resolution, and the view as passed by majority vote and as included in the Resolution show that the position in it is for international protection of those agreements.

One can also find this nationalist view in the decisions of international tribunals. Amerasinghe sites many decisions in which the view that municipal law of the host state is the governing law was adopted, some of which are the Illinois Central Railroad Co. Case and the International Fisheries Co. Case.[90] In the former the issue was whether tribunal had jurisdiction over the matter for the Mexican Government argued that only breaches of international law were within tribunal's jurisdiction. In answering the issue the tribunal implied that a breach of concession agreement was *not perse* a breach of international law.[91] Again in the International Fisheries Co. case, in which the cancellation of the contract by the Mexican Government was in issue, the tribunal stated that the cancellation could have been contested in the Mexican courts for the act "was not an arbitrary act which in itself might be considered as a violation of some rule or principle of international law."[92] It is clear that the tribunal took the view that a breach of contract *per se* is not a breach of international law.

Even in cases in which non-national legal system was applied, the reason to do so, Sornarajah argues, was the absence of a sufficiently mature national system of law to deal with problems of foreign investment disputes.[93] He invokes two instances to

---

[90] Amerasinghe, supra note 52, pp. 79-80
[91] Ibid., p. 80
[92] International Fisheries Company Case (1931), quoted in Amerasinghe, supra note 52, p. 80.
[93] Sornarajah, supra note 78, 113.

substantiate his view, the Abu Dhabi Arbitration and the Qatar Arbitration. In the Abu Dhabi Arbitration the reason to reject the law of Abu Dhabi as the one to be applied in solving the dispute was that "it was fanciful to suggest that in this primitive region, there was any settled body of legal principles applicable to the construction of modern commercial instruments."[94] In the Qatar Arbitration the arbitrator, Sir Alfred Bucknill, asserted that the national law of Qatar was applicable to the dispute. He observed: [95]

> *If one considers the subject matter of the contract, it is the oil to be taken out of the ground within the jurisdiction of the Ruler. That fact, together with the fact that the Ruler is a party to a contract and had, in effect the right to nominate Qatar as the place where any arbitration arising out of the contract should sit and the fact that the agreement was written in Arabia as well as English, points to Islamic law, that being the law administered at Qatar.*

He, however, held that the Islamic law was inapplicable and that the dispute had to be settled in accordance with the principles of justice, equity and good conscience, for the contract would have been invalid under that system.[96]

These cases reveal that account was taken of the sovereign quality of one of the parties and that the national law of the sovereign should be applied to the dispute. Sornarajah, therefore, argues that internationalization of foreign investment agreements on the basis of these awards, which presupposed the inadequacy of the national laws, is not well founded.[97]

One can also understand from Lord McNair's paper on the question of the law applicable to foreign investment agreements that he was aware of the fact that these

---

[94] The Abu Dhabi Arbitration Award (1951), quoted in Sornarajah, supra note 78, p. 114.
[95] The Qatar Arbitration Award (1952), quoted in Sornarajah, supra note 78, p. 114.
[96] Sornarajah, supra note 78, p. 114.
[97] Ibid.

arbitration awards had stressed the unavailability of the local laws to settle the dispute.[98] His proposition that "general principles of law" should be applied to the agreement under discussion seems to have been limited to a situation in which the national system of a state party was not sufficiently mature to deal with disputes arising from the agreement. Thus, he submitted:[99]

> *One of the difficulties that arises in finding a system of law appropriate to the type of contract under discussion arises from the fact that many of the countries which require skill and capital from outside for development of their natural resources are governed by some system of law which has not been developed to deal with this particular type of transaction.*

2.2.3 International Law

The types of agreements under consideration do not belong to the category of treaties, neither should they be confused with private contracts. Contracting parties are of different quality since one is a state and the other a private corporation or individual. This inequality can be explained more in terms of the difference in interest each party is seeking. The purposes sought and the interests represented by the parties are different. The foreign investors' purposes are essentially private in character, since they relate to the financial interests of the corporation or the individual. The state, on the other hand, represents the general interests of a community of persons. It is on this difference that the special characteristic of concession agreements is based.

Accordingly, these agreements, Verdross maintains, form a third group of agreements which are governed by the concurring wills of the parties.[100] He asserts that the *lex*

---

[98] McNair, supra note 28, p.1
[99] Ibid. p., 4
[100] Verdross, supra note 21, p. 121.

contractus is an independent legal order regulating the relation between the parties exhaustively, and that any other legal order can be applied only in as much as it is delegated by the *lex contractus*. [101]

McNair[102] and Bourqin[103] also hold that parties to a concession agreement are free to agree upon such terms as they may choose, thereby making their own law. They, however, admit that intentions of the parties cannot be expressed in every case precisely.[104] It is impractical to expect that every relation or point of possible dispute be regulated by the agreement. The agreement merely represents part of the contractual order, and it remains to be incomplete. As such for the purpose of interpretation and filling the gaps resort shall be had to some other legal order. Using their discretion parties may indicate in their agreement a legal system which shall supplement the contractual provisions. Accordingly, it is submitted that parties can choose public international law as that system.[105]

The problem arises when there is no such express choice. It has been argued that international arbitration provisions or clauses in the contract pointing to the parties' obligation to act according to good faith and good will indicate that the agreement is to be governed by international law.[106] The idea is that an inference as to the choice of international law as the proper law of the agreement can be made even in the absence of an express choice.

---

[101] Ibid., p. 121.
[102] McNair, supra note 28, p. 8
[103] Bourquin, supra note 11, p. 110.
[104] Ibid.
[105] Danielle Mazzini, "Stable International Contracts in Emerging Markets", Boston University International Law Journal (Vol. 15, 1997), p. 344.
[106] Jennings, supra note 60, p. 156.

The extreme argument is that even in the absence of such clauses the nature of the concession agreement is such that disputes arising from it must be settled in accordance with international law. Some hold the view that concession agreements in all essential respects are analogous to treaties and, therefore, are governed by international law.[107] One branch of arbitral practice, it is submitted, supports the belief that breach of contract is *per se* wrongful conduct in international law.[108] Texaco V. Libya is one such instance in which the Arbitral Tribunal held that international law must be applied because the contract between the Corporation and the State was international.[109] Danielle Mazzini goes even further in stating that the concession agreement implicitly requires an arbitrator to consider international law even if parties might have agreed that municipal law of the state would apply.[110]

One reason on which such view is based relates to the interest of the home state. The idea is that breach of a concession agreement constitutes a violation of the international rights of the state of which the individual party is a national.[111] This makes the individual only apparently a party in the case; that in reality the home state is behind him, and this state is the interested contracting party. This is what the Permanent Court of International Justice held in a case:[112]

> *By taking up a case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on its behalf, a state is in reality asserting its own rights-its right to ensure, in the person of its subjects, respect for the rules of international law.*

---

[107] Kissam and Leach, supra note 2, p. 380.
[108] Mazzini, supra note 105, p. 357.
[109] Ibid.
[110] Ibid.
[111] Friedman, supra note 55, p. 154; Foighel, supra note 19, p. 164; Jennings, supra note 60, p. 161.
[112] The Mavromatis Palestine Concessions Case, P. C. I. J. Report (1924), quoted in Kissam and Leach, supra note 2, p. 380.

Schewebel maintains that the view that the individual cannot be a subject for international law has long been abandoned in current theory.[113] Thus, there is nothing to prevent an individual entering into agreements with another party subject to international law-a state- for the conclusion of internationally legally binding contracts. Garcia-Amador, the United Nations Special Repporteur on International Responsibility, stated in his report that in recent days international law recognizes the direct entitlement of individuals to international rights, and that "the alien has been internationally recognized as a legal person independent of his state; he is a true subject of international rights."[114]

Another justification for recourse to international law goes to the need to protect the private contracting party from unilateral and sudden modifications of legislation in the contracting state. A tribunal in a case[115] emphasized this need as it stated that:

> *... parties entering into such agreements and committing large amounts of capital over a long period of time require contractual guarantees for their security; governments of developing countries in turn are willing to provide such guarantees in order to promote much needed economic development.*

The theory of internationalization of concession agreements here is based on a policy argument as to benefits which such agreements bring. The assumption is that investments which promote development would not flow to the developing countries unless legal mechanisms assuring protection were existent. Unless such protection is conferred on the agreement, private investment flows necessary for economic

---

[113] Stephen M. Schwebel, International Protection of Contractual Arrangements (1959), cited in Foighel, supra note 19, p. 166.

[114] Lowell C. Wadmond, "The Sanctity of Contract between a Sovereign and a Foreign National", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 144.

[115] Revere Copper and Brass Inc. V. Overseas Private Investment Corporation (1978), quoted in Sornarajah, supra note 78, p. 85.

development will be impeded. Thus, in the Sapphire Award[116] the arbitrator said that protection of concession agreement through internationalization was "indispensable for foreign corporations, which undergo very considerable risks in bringing finance and technical aid to countries in the process of development". Implicit in the objective of development is, therefore, a policy argument favouring the conferment of maximum protection upon the investment agreement between a state and alien by subjecting it to international law.

Application of international law rules to disputes arising from concession agreements is also justified on the basis of similarity between these agreements and treaties. In concession agreements a state, which is a typical subject of international law, is a party. Bourquin, therefore, argues that application of international law rules to concession agreements is justified in the same way as their application to the international order proper.[117] James N. Hyde also claims that application of rules of international law in many arbitrations relating to concession agreements is based on analogy.[118] It seems on the basis of the same reasoning, i.e., analogy, that in the Losinger and Co. Case Switzerland, taking up the case of its national, invoked the principle of *pacta sunt servanda* and asked the Permanent Court of International Justice to declare the Yugoslav attitude unlawful.[119] This view has also gained support in the American Section of the International Law Association where it was stated: "The principle *Pacta Sunt Servanda*... applies not only to agreements directly concluded between states, but

---

[116] The Sapphire Award (1936), quoted in Sornarajah, supra note 78, p. 87.
[117] Bourquin, supra note 11, p. 869.
[118] "Abu Dhabi Arbitration Award, In the Matter of an Arbitration between Petroleum Development (Trucial Coast) Ltd. And the Sheikh of Abu Dhabi", International and Comparative law Quarterly (Vol. 1, 1952), London, The Society of Comparative Legislation, p. 247.
[119] Mann, supra note 54, p. 577.

also to those between a state and foreigners."[120] Thomas W. Waeld and George Ndi maintain that international law, in particular the law of treaties, being state-to-state law is, atmost applicable by analogy.[121]

Lord McNair points out that the rules of international law that are applicable to concession agreements are those mentioned in Art 38 (1c) of the Statue of the International Court of Justice as "the general principles of law recognized by civilized nations."[122] Bourquin also claims that application of these principles to concession agreements is perfectly justified.[123] General principles of law having their source in the municipal systems and being applicable to states relations seem fit to govern concession agreements.

Many concede on the applicability of general principles of law to concession agreements especially when the latter contain certain indicia as to these rules. In the Sapphire Petroleum Arbitration the arbitrator held that general principles of law are applicable because there existed indications to that effect.[124] The agreement involved exploitation of petroleum resources by Sapphire in Iran. In answering the issue as to the applicable law the arbitrator held that the law applicable to the agreement was the general principles of law recognized by civilized nations. The ruling was justified on the basis of the seat of the arbitration specified in the contract and the reference in the contract to good faith and good will in the carrying out of the contract. The arbitration,

[120] Foighel, supra note 19, p. 165.
[121] Waelde and Ndi, supra note 9, p. 235.
[122] McNair, supra note 28, p. 18.
[123] Bourquin, supra note 11, p. 868.
[124] The Sapphire Award (1963), cited in Sornarajah, supra note 78, p. 116.

moreover, indicated that the need to protect such agreements implies the application of general principles as it stated: [125]

> *Such a solution seems particularly suitable for giving the guarantees of protection which are indispensable for foreign companies, which undergo considerable risks in bringing financial and technical aid to countries in the process of development. It is in the interests of both parties to such agreements that any dispute between them should be settled according to the general principles universally recognized and should not be subject to the particular rules of national laws, which are very often unsuitable for solving problems concerning the rights of the state and are often unknown or badly known to one of the contracting parties.*

A similar view was taken in the three arbitral awards made in connection with the Libyan nationalization of oil concessions.[126] The cases arose out of the same act of nationalization. Arbitrators in all the three cases held that foreign investment agreements containing certain indicia such as choice of law clause, arbitration clause or a stabilization clause are international contracts and that disputes arising from such agreements should be settled according to the rules of public international law.[127]

Examination of different concession agreements shows that they contain indications as to application of general principles of law. These indicia take different forms. Most of such provisions are of a very general nature, such as "the principle of good will and good faith," or "good will and reasonable interpretation," or "legal principles familiar to civilized nations," or other similar expressions.

Article 22(1) of the concession agreement of April 29, 1933, between Iran and the Anglo-Iranian Oil Company provided for arbitration and further stated that the award

---

[125] Ibid.
[126] C. Greenwood, "State Contracts in International Law – The Libyan Oil Arbitrations", The British Yearbook of International Law (vol. LIII, 1983), London, Oxford University Press, p. 27.
[127] Ibid.

should be based on principles contained in Art. 38 of the Statute of the Permanent Court of International Justice.[128] The agreement between the Ruler of Qatar and the Anglo-Persian Oil Company (May 17, 1935) stated that the award should conform to the legal principles familiar to civilized nations.[129] Still another concession contract entered in 1939 between the Ruler of Abu Dhabi and Trucial Coast (Petroleum Development) contained the declaration of parties that their work be based on good will, sincerity of belief and reasonable interpretation of the agreement.[130] Article 46 of the Agreement of 1954 between Iran and American, British, Dutch and French Corporations provides:[131]

> *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 of law recognized by civilized nations in general, including such of those principles as may have been applied by international tribunals.*

The conclusion that can be drawn from the foregoing examples is that the parties intended that their agreements be governed by some non-national law. The parties felt that a system which may be called the general principles of law should be applicable. The agreements clearly indicate that the parties were looking beyond the local law of either party for settlement of their disputes. Leo T. Kissam and Edmond K. Leach assert that these agreements are typical examples of the usual intent of the parties not to rely upon the municipal law of either party. [132]

---

[128] McNair, supra note 28, p. 10.
[129] Fatouros, supra note 10, pp. 289 –90.
[130] McNair, supra note 28, p. 10
[131] Quoted in McNair, supra note 28, p. 11
[132] Kissam and Leach, supra note 2, p. 383.

The fact that these agreements make reference to good will, reasonable interpretation, arbitration or contain equivalent clause is an evidence that the parties are not thinking in terms of municipal law. The parties are relying on something more universal and impartial than the local municipal law of either party. The parties do not regard the national law of either of them as affording an adequate or appropriate legal system within which these contracts can operate. Lord McNair submits that in contracts of this type the parties intend that their contracts should be governed by the general principles of law recognized by civilized nations.[133]

There are also arbitration instances in which these clauses have been accepted as referring to general principles of law. In the Lena Goldfield Arbitration of 1930 the Tribunal had to consider what was the proper law of the concession agreement between the U.S.S.R Government and a British company.[134] The company was given rights of exploration and mining in Russian territory. The Concession Agreement (Art. 89) further provided that "the parties base their relations with regard to this agreement on the principle of goodwill and good faith as well as on reasonable interpretation of the terms of the agreement."

The Company contented that the agreement was breached by legislative and administrative act of the Soviet Government and that the general principles of law recognized by civilized nations, referred to in Art. 38 of the Statue of Permanent Court of International Justice, should be applicable to determine the breach and the damages thereto.[135] The Tribunal accepted this submission by the Company as to the applicable

[133] McNair, supra note 28, p. 12.
[134] Ibid., pp. 12-13
[135] Ibid., p. 13

law on the ground that many of the terms of the agreement contemplated such principles of law.[136]

A similar conclusion was reached in Abu Dhabi Arbitration (Petroleum Developments (Trucial Coast) Limited V. the Ruler of Abu Dhabi).[137] In the Agreement from which the dispute arose it was declared that the parties base their work on goodwill and reasonable interpretation (Art. 17).

One of the points to be determined by the arbitration related to the applicable law. And it was held that the terms of the hereinabove indicated clause in the Agreement prescribed application of principles "rooted in the good sense and common practice of the generality of civilized nations,"[138] thereby referring to the general principles of law. Thus, we see the view that those general clauses in agreements refer to general principles of law has got arbitral recognition.

The question often is asked: what are these general principles of law? McNair states that it is not possible to point to any code or book containing them.[139] He maintains that these principles will be developed both by contracting parties and by tribunals which are called upon to adjudicate upon contracts of this type.[140] Possibility of preparing a complete inventory of these principles seems doubtful. The idea is that more and more of them will come to be expressed as they are applied by courts or tribunals in specific cases. Ray states that these principles will develop in the same way as the common law did.[141]

---

[136] Ibid., p. 14
[137] The Abu Dhabi Arbitration Award, supra note 118, p. 247.
[138] Ibid.
[139] McNair, supra note 28, p. 18.
[140] Ibid.
[141] Ray, supra note 25, p. 490.

Both Fatouros[142] and Richard Young[143] admit that this phrase, which comes from Article 38 of the Statue of the International court of Justice, is broad and uncertain in scope, and that comparative research on municipal systems is important to clarify its content. The idea is that comparison of municipal systems of civilized nations reveals certain traits common to them all. No doubt each of these internal systems do have differences and their own particularities. But certain notions or principles are found everywhere. Inclusion of these principles in the Statue as one source of international law is justified on this fact. As such these principles are valid both in international and internal law.

Many agree that the existence in the contract of a choice of law clause, an arbitration clause or a stabilization clause indicate the intention of the parties that their agreement be subject to international law. The following sub-sections deal with the possibility of subjecting concession agreements to International law by including these clauses in the agreement.

2.2.3.1Choice of Law Clause

The question may arise as to whether a law other than the law of the host state can be validly chosen to govern a concession agreement. We have seen in the foregoing paragraphs that the parties may choose the legal system which is to govern their agreement. The right of the parties to choose the system of law which will be applicable to their contract seems to have been widely recognized. Amerasinghe maintains that the autonomy of the parties to choose the applicable law is the basic public international law principle.[144] The International Convention for Settlement of Investment Disputes

[142] Fatouros, supra note 10, p. 295.
[143] Young, supra note 3, p. 919.
[144] Amerasinghe, supra note 52, p. 108.

(ICSID) also provides contracting parties with a choice of law standard. Article 42 (1) of the Convention gives effect to the party autonomy theory of choice of law.

It, therefore, follows that the parties may choose international law as applicable law. The International Law Institute has admitted that "a contract may be denationalized by providing that it should be governed by international law or by general principles of law."[145] It is claimed that the implication of the choice of international law as the governing law of contract is to render applicable to the agreement certain international norms such as the doctrine of sanctity of contract (pacta sunt servanda).[146] The idea is that international law provides external legal protection in the event of conflict between the foreign investor and the host state. To benefit form such protection the investor will often seek to internationalize the agreement. This goal can be achieved through the medium of choice of law provision which subjects their relationship to international law.

Investors concluding investment contracts with a host state obviously want to obtain a firm binding commitment of their state partner. If such contract is governed by the law of the host state, the investors concerned are afraid that the host state as a law giver, by a change of this governing law, may nullify its promises. Investors over many years have tried to denationalise such contract. This aim will be fulfilled if the contract concerned provides that it shall be governed by international law.

The choice of law clause as to international law may take different forms, express or implied. By express choice parties clearly refer to international legal system as

---

[145] Art. 2 of The Resolution on the Proper Law of the Contract in Agreements between a State and a Foreign Private Person (1979), cited in Ignaz Seidl – Hohenveldern, Collected Essays on International Investments and on International Organizations, London, Kluwer Law International (1998), p. 197.

[146] Waelde and Ndi, supra note 9, p. 236.

governing their relationships arising from the contract. The parties may also, by making reference to some principles of general nature, imply applicability of international law. For instance, in the Sapphire Arbitration the arbitrator chose international law as applicable law. The basis of such inference was the fact that the parties to the agreement undertook to carry out the contractual provisions according to the "principles of good faith." This is clear from statements of the arbitration that:[147]

> *... a reference to rules of good faith... leads the judge to determine according to the spirit of the agreement, what meaning can be reasonably given to a provision of the agreement which is in dispute. It is therefore perfectly legitimate to find in such a clause evidence of the intention rather to rely upon the rules of law, based on reason, which are common to civilized nations. These rules are enshrined in Article 38 of the Statue of the International Court of Justice as a source of law...*

Even in the absence of these principles of general nature the inference as to applicability of international law, it was held, could be made because of the very nature of concession agreements. In a case[148] which arose from the nationalization of the bauxite mines in Jamaica and which related to an investment agreement that did not contain a choice of law clause, the U.S. tribunal held that international law was applicable. The tribunal stated that the nature of the agreement and the fact that it aimed at economic development indicated that a choice of law clause had to be inferred.[149] It further held that the need for the security of such investments justified the application of international law to disputes arising from the agreement, despite the absence of any choice of law clause.[150] The idea here is that in agreements between states and foreigners, the parties contemplate that some other system of law than a

---

[147] The Sapphire Arbitration, supra note 116, pp. 101-102.
[148] Revere Copper and Brass Inc. V. Overseas Private Investment Corporation (1978), cited in Sornarajah, supra note 78, p. 102.
[149] Ibid.
[150] Ibid.

specific national system should be applicable. The main reason for the parties contemplating such a neutral system as the governing law appears to be that the contract could not have been concluded had no protection been given to the alien's interest in having assurance of some legal security against action by state party to the contract.

The theory of choice of law is not, however, without objection. The difficulty of applying the theory, it is submitted, lies on the fact that one of the parties has no international personality. If a contract is governed by international legal system, it follows that both parties have a right to invoke international law to settle any grievances arising out of the contract. This amounts to giving the alien international personality through the choice of law. This consequence which enables the alien individual to sue or to be sued at international sphere, Amera- Singhe hodls, goes against the present state of international law.[151] The idea is that however desirable it may be that the parties make contracts which have their existence in international sphere, the present state of international law does not permit such internationalization.

This objection is based on the assumption that international law does not recognize personality of individuals. But the present trend is that individuals are being given international personality with respect to different international legal problems. As such the question of personality of the alien cannot create a general difficulty on the principle of choice of law.

[151] Amerasinghe, supra note 52, p. 96

2.2.3.2 Arbitration Clause

Concession agreements usually contain arbitration clauses providing that disputes concerning the agreement be submitted to arbitral proceedings. Sornarajah maintains that the validity of arbitration clauses is not contested.[152]

Instances of concession agreements containing arbitration clause are abundant. Some examples will illustrate such arbitration clauses:[153] Article 22(A) of the Agreement between Iran and the Anglo-Iranian Oil Company Ltd. (April 29, 1933) provides that differences between parties arising out of the interpretation of the agreement... shall be settled by arbitration." Article 21 of the Agreement between Saudi Arabia and the Arabian American Oil Company (ARAMCO), May 29, 1933, provides to the same effect. It states that in case "doubt, difference or dispute arises... concerning the interpretation or execution of this contract... it shall ... be referred to ... arbitrators...." As per Article 26 of the Agreement between Syria and the Maritime Refineries, Ltd. (June, 6, 1949) any dispute that would possibly arise between the parties concerning interpretation or application of the Agreement was made subject to arbitration. The words read, "any doubt, differences... concerning interpretation or execution... shall, failing any agreement to settle it, ... be referred to two arbitrators..." We find similar stipulation in Article 28 (a) of the Agreement between Qatar and the Shell Overseas Exploration Company, Ltd. (November 29, 1952): "if any doubt or dispute shall arise between the Sheikh and the Company concerning the rights or liabilities of either party, ... the matter shall be referred to two arbitrators...."

---

[152] Sornarajah, supra note 78, p. 98
[153] Verdross, supra note 21, p. 126.

The existence of arbitration clauses in investment contracts between states and foreign corporations has been used to support the theory that such contracts should be treated as international contracts, and hence subject to non-municipal legal order. Verdross asserts that arbitration clauses clearly prove that these agreements are not part of the legal order of the contracting state.[154] The idea is that when the parties to the concession agreement subject disputes arising out of the agreement to arbitral proceedings, they establish that rights and obligations in the agreement cannot be construed according to the municipal law of the host state.

There is connection between the tribunal or court having jurisdiction and the applicable law. A municipal court which assumes jurisdiction will decide on the basis of municipal law. Giving power of adjudication to a different body of arbitrators, on the other hand, implies intention on the part of parties that some non-municipal law be applied in case of dispute. The purpose of including arbitration clause in concession agreements, Amerasinghe submits, is to exclude the jurisdiction of the municipal courts of the state party to the contract and to have remedies provided by an independent tribunal not connected with that legal system.[155] The reason behind this is that the municipal courts of the state party would be bound to give effect to the law of that state. The point is that exclusion of municipal jurisdiction is aimed at better protection of the investment.[156] The alien brings to the host state technical and financial assistance in which is involved considerable risks. Such investment should be protected against a state measure and it should be assured of some legal security.

---

[154] Ibid.
[155] Amerasinghe, supra note 52, p. 109.
[156] Ibid.

Thus, a tribunal which assumes jurisdiction over contracts between a state and an alien is not to be identified with municipal legal system. It is stated that the tribunal would naturally find easier to choose international law as the proper law of the contract.[157] Such tribunal should not take cognizance of changes in a municipal law which purports to affect the contract. In the case of Texaco Overseas Petroleum Company and Others V. The Libyan Arab Republic the arbitrator held that the concession agreements between the two parties constituted a contract which had been internationalized by virtue of the provisions for recourse to international arbitration for the settlement of disputes.[158] Jennings, accordingly, maintains that the application of municipal law should not have the effect of ruling out the application of principles of international law.[159]

A concession agreement containing arbitration clause, it is suggested, is not a contract governed by the legal order of a state, but a legal order established on the basis of general principles of law or by principles of international law.[160] As such an arbitration clause seeks to remove disputes arising from the investment contract from the jurisdiction of national courts.

The state and a foreign corporation are intent on maintaining good relations with each other. Both parties would readily submit their dispute to arbitration by a neutral tribunal. It must be submitted, therefore, that the choice of jurisdiction can affect the choice of the law governing the contract.

---

[157] Ibid., p. 113.
[158] Asante, supra note 40, p. 697
[159] Jennings, supra note 60, p. 180.
[160] Sornarajah, supra note 78, p. 98.

2.2.3.3 Stabilization Clause

The stability of investment conditions responsible for performance of the investment venture is at the heart of investor concerns. Stability of the fiscal regime (standard taxes and specific payments for depletion of resources) is the key-issue for stabilization concerns. Any other government-imposed obligation that is likely to disrupt the financial returns is the object of stability concerns. The question mainly raised here relates to the relationship between a concession agreement and subsequent legislation changing the economic framework or conditions underlying the agreement.

The basis of stabilization questions, Asante submits, is the concern of foreign corporations in certainty and predictability of their relations with the host states.[161] True, before committing resources to such long-term concession agreements an alien investor carries out elaborate financial projections to determine the expected return from the investment. Such determination is possible only when government fiscal impositions (such as tax, rents, etc.) are known to the investor and will not be changed.

Another possible basis of the stability concern, than the investors' need for predictability of the transactions, Sornarajah suggests, is the view that, in case of silence, the proper law of the contract is the law of the host state.[162] The object of the stabilization clause, therefore, seems to insulate the agreement from subsequent changes in the host state's law which may affect the investment agreement. The idea is that in the absence of stabilization clause the host state may possibly change the terms of the contract

[161] Asante, supra note 40, p. 700.
[162] Sornarajah, supra note 78, p. 92.

unilaterally through its legislation. The importance of certainty in the contractual relations of states and private investors was stressed by Dunn who observed:[163]

> *If a government is free to have recourse to its sovereign power to escape is obligations under a contract with a private individual, then doing business with governments on a contractual basis becomes a wholly uncertain thing, so far as a private contractor is concerned. No matter how he could seek to safeguard himself in the terms of the contract against possible loss, the state might through the exercise of its supreme governmental power, overturn all his calculations. Private contractors would not safely do business with governments on any such terms.*

All these views hold that there is the need to stabilize the parties' relations when a state contracts with private investors. It would be unfair to the private investor, who has put his capital in an enterprise on the faith of protection granted by his contract, to be later confronted with the state's denial of its promises contained in the agreement.

Waelde and Ndi state that the political risk of unilateral change in the established fiscal regime by government intervention is well-known, and that these political risk events are often painfully inscribed in the institutional memory of companies.[164] Stabilization concerns are, thus, dictated by the need on the part of the companies to minimize that risk. This compels governments to go to considerable lengths to fashion their investment regimes to respond to foreign investor concerns. Therefore, promises not to alter a given legislative regime, Waelde and Ndi maintain, have emerged as an important tool of foreign investment promotion policy.[165]

Thus, we see that stabilization clauses are meant to protect parties' promises from change by unilateral government action. Asante, who considers stabilization clauses as familiar mechanism for ensuring investment guarantees, defines them as "stimulations

---

[163] B. Dunn, the Protection of Nationals (1932), quoted in E. I. Nwogugu, The Legal Problems of Foreign Investment in Developing Countries, Manchester University Press (1965), p. 182.
[164] Waelde and Ndi, supra note 9, p. 232.
[165] Ibid., p. 219.

designed to stabilize or freeze the essential provisions of the agreement by strictly prohibiting any legislative or administrative act which derogates form the provisions of the agreement."[166] Nigel Rawding describes a stabilization clause as any provision contained in the agreement between a state and a private party by which the state undertakes not to change the terms of the contract.[167]

These definitions reveal that the inclusion of the stabilization provision in the agreement is an attempt to control the future and to minimize some risks. Stabilization clauses address the futureness problem inherent in long-term concession agreements. A stabilization clause insulates the parties' contractual obligations from any external occurrences that would have an impact on the legal content of those obligations. The clause benefits foreign investors by prohibiting the contracting state from citing externalities to justify unilateral contract termination. It seeks to give to the agreement more force than it seems to generate by itself. The stabilization clause is, therefore, an attempt to bind the state to a greater extent than the normal contract would seem to do.

The inclusion of a stabilization clause is intended to fetter the state party from using its legislative sovereignty to change its laws in such a manner as to alter the terms of the investment agreement. The investor would prefer to keep the conditions under which he made the agreement constant. Sornarajah observes that the state agrees to the inclusion of this clause not only because of its keenness to attract the investment but also because it realizes that third parties, like banks, which finance the project may not be willing to participate in the venture without inclusion of the clause. [168]

---

[166] Asante, supra note 40, pp. 700 – 701.
[167] Nigel Rawding, "Protecting Investments Under State Contracts: Some Legal and Ethnical Issues", Arbitration International (Vol. 11, 1995), London, Kluwer Law International, p. 347.
[168] Sornarajah, supra note 78, p. 92.

Many concession agreements involve stabilization clauses. One such instance is to be found in three concession agreements which the Libyan Government concluded with BP, Texaco and the Libyan American Oil Company. The agreement between Libyan Government and Texaco included a stabilization clause in the following terms: [169]

> *The government of Libya will take all steps necessary to ensure that the company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties.*

Likewise the Iran-Consortium Agreement (1954), in which the Government of Iran concluded an agreement with American, British, French and Dutch companies, contained a stabilization clause. By article 41 (B) the Government of Iran undertook not to annul or modify the agreement by general or special legislative or administrative measures.[170] The Ghana-Valco Agreement (1960) between the Government of Ghana and the Volta Aluminum Company relates to the construction and operation of aluminum smelter to utilize electric power produced from the dam to be constructed on the Volta River.[171] The Government promised not to derogate from its grant:[172]

> *No general or special legislative or administrative measure or act whatsoever of or emanating from Ghana or any Ghanian authority shall annul, amend, revoke or modify the provisions of, or prevent or hinder the due and effective performance of the terms of the contract;.... Any such measure r act shall be deemed to be an act of expropriation within the law of Ghana and under international law.*

The legal effect of a stabilization clause, many agree, is that of subjecting the agreement to international law. It is admitted that addition of a stabilization clause

---

[169] Clause Sixteen of the Agreement, quoted in Sornarajah, supra note 78, p. 92.
[170] The Iran-Consortium Agreement (1954), cited in Nwogugu, supra note 162, p. 169.
[171] Nwogugu, supra note 162, p. 170.
[172] Ibid., p. 171.

makes application of the *pacta sunt servanda* principle to the agreement possible.[173] It was also held that a government action that expropriates property of the alien against a stabilization clause in the agreement is illegal in international law.[174] In the same way the arbitrator in the Texaco Case found that Libya had acted in breach of the Concession Agreement and that the act of nationalization against the stabilization provision was an illegal act under international law.[175] These instances show that inclusion of a stabilization clause in the agreement imply the intention of the parties to subject the transaction to international law.

[173] Waelde and Ndi, supra note 9, p. 236.
[174] Nwogugu, supra note 162, p. 169.
[175] Rawding, supra note 166, p. 349

CHAPTER THREE

SANCTITY OF CONCESSION AGREEMENTS IN INTERNATIONAL LAW

Even among those who accept applicability of international law to concession agreements there is difference in opinion as to the position of the law. Some argue that international law requires parties to respect their promises, while others state that international law permits a state party to the contract to set aside its undertaking.

On the one hand, it is said that a state may act against the agreement if this is for public purpose and is followed by compensation.[1] The state has the right to take property of an alien provided it pays something. The idea is that a state may abrogate its contracts if it claims to so act in the public interest and if it pays some compensation. The acts of state are not to be questioned by any. But no rights are beyond the reach of the state.

On the other hand, it is submitted that if a contract is performed by one party, it should be performed in good faith by the other.[2] The rights of the alien in the contract have the protection of international law, that the state should not be allowed to escape its responsibilities.

It is agreed that rights granted to foreigners in concession agreements will enjoy no less degree of protection than rights which aliens acquire in host states without concession agreements in accordance with local legislation.[3] The problem is only whether

---

[1] George W. Ray, "Law Governing Contracts between States and Foreign Nationals", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 469.
[2] Ibid.
[3] Isi Foighel, Nationalization and Compensation, London, Stevens and Sons Limited (1964), p. 178.

international law affords better protection against violation of rights granted in a concession than that extended to other rights of aliens.

Dunn observed that the question of international responsibility for breach of concession agreements presented a diversity of views among legal authorities and confusion of precedents.[4] And he goes on stating that it is possible to make arguments both for and against responsibility, and to support each of them by precedents.[5] A submission is also made that it is impossible to say whether or not there is a rule of international law entailing responsibility for breaches of contract.[6] The following sections deal with these different views as to the position of international law on breach of concession agreements.

3.1 The No Respect Theory

It is argued by some that the international law on the subject is such that agreements between states and individuals cannot be recognized as binding. A number of reasons are adduced in support of this contention. Principally it is said that a state possesses sovereign character that it cannot contract away its powers of taking unilateral action in the future. This is also stated in other words, that the state's power to take any action in protection of public good should not be fettered as the state is the guardian of public interest.

---

[4] B. Dunn, The Protection of Nationals (1932), cited in Leo T. Kissam and Edmond K. Leach, "Sovereign Expropriation of Property and Abrogation of Concession Contracts", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 393.
[5] Ibid.
[6] Kissam and Leach, supra note 4, p. 393.

It is claimed that sovereignty, i.e., economic sovereignty or permanent sovereignty over natural resources, constitutes *jus cogens* which a state cannot waive.[7] An attempt by a state to bind itself through contract would, therefore, constitute a derogation from the principle of sovereignty. The view is that while states could exercise their sovereignty in making agreements with foreign companies, sovereignty would also constitute a lawful ground for the termination of these agreements.

This view based on sovereignty has been advanced since the time of Jean Bodin in sixteenth century. By way of showing the power of the state to change its own promise at will, Bodin stated that no one could bind himself through his own laws and that no law was so sacred that it could not be changed when the welfare of the state so requires.[8] One would easily conclude from this that concession agreements need not be observed if their performance is no longer in the interest of the state. For Jellenik, too, a lasting restriction of state power amounts to surrender of sovereignty.[9] The point in his view is that the binding force of concession agreements rests on the "self-imposed obligation" of states, that a state can release itself from such restrain at its own will.[10] If there is no higher will which compels the state to keep its word, then there is no sufficient basis given to the contract which obligates the state to observe it. If the validity of the agreement is to be based on the will of the state, international law would be undermined. Entering into binding transactions should not be taken as contradiction to

---

[7] Thomas W. Waelde and Georg Ndi, "Stabilizing International Investment Commitments: International Law Versus Contract Interpretation", Texas International Law Journal (vol. 31, 1996), Texas, Austin School of Law Publications Inc., p. 236.
[8] Hans Wehberg, "Pacta Sunt Servanda", American Journal of International Law (Vol. 53, 1959), Washington, D.C., Lancaster Press Inc., p. 777.
[9] Ibid., p. 778.
[10] Ibid., p. 781.

sovereignty. It is submitted that "the right to make binding obligations is a competence attaching to sovereignty."[11]

The idea implied in the aforesaid view of sovereignty is that a mere contractual promise on the part of the state does not do away with its international right to undo the commitment. It follows that an agreement between state and a foreigner creates no better right than he could enjoy in the absence of the agreement. Conversely the agreement adds no new international obligation upon the state. There are some who, for example, argue that taking of an alien property in violation of the agreement does not contradict international law, for the same rules that govern nationalization of property in general should apply to concessions. Thus, Foighel observes that:[12]

> *The fact that nationalization is not a breach of international law cannot be altered by the fact that nationalization destroys contract rights, for example, a concession which the nationalizing state has granted to a foreign company....There is no rule in international law that gives a greater degree of protection to rights secured by contract than to other rights of property.*

Likewise, Robert Delson submits that there exists an absolute state right to terminate state contracts with aliens.[13] It has also been stated that an overwhelming majority of writers have concluded that the taking of the property of an alien by a state is not legally wrong, and that only failure to compensate the alien is wrong.[14] In Libyan-American Oil Company arbitration the arbitrator held that the principle that contracts are binding was qualified by state's right to nationalize its resources, and that nationalization was a legitimate exercise of sovereign power subject to payment of compensation.[15]

---

[11] Ray, supra note 1, p. 504.
[12] Isi Foighel, Nationalization (1957), quoted in Kissam and leach, supra note 4, p. 393.
[13] R. Delson, "Nationalization of Suez Canal Company: Issues of Public and Private International Law", Columbia Law Review (vol. 57, 1957), New York, Columbia Law Review Association Inc., p. 784.
[14] Ibid., p. 755.
[15] Nigel Rawding, "Protecting Investments Under State Contracts: Some Legal and Ethnical Issues", Arbitration International (vol. 11, 1995), London, Kluwer Law International, p. 349.

The aforementioned views show that the problem of nationalization of a concession, in the same way as the problem of nationalization of other a rights of ownership belonging to foreigners, is the problem solely of the liability of the nationalizing state to pay compensation. The fact that the state has given foreigners certain rights by contract does not impose any different restrictions on the powers of the state to nationalize or to breach the contract. This means no rule exists in international law which gives more protection to rights created by contract than the protection existing for other rights of ownership of property.

Foighel makes an assertion that there exists no practice in international law which would support the idea that the action against property contrary to a direct undertaking given in a contract is invalid in international law.[16] An affirmative statement as to the power of the state to intervene in a contract was made in the early twentieth century case of Company General of the Orinoco: [17]

> *As the Government of Venezuela, whose duty of self preservation rose superior to any question of contract, it had the power to abrogate the contract in whole or in part. It exercised that power and cancelled the provision of assignment. It considered the peril superior to the obligation and substituted therefore the duty of compensation.*

The point remains that a state which entered into the contract can either perform it or break it, provided, in the latter case, it pays damages. It follows that a state has the right to take another's property, despite contractual commitments, if it is willing to pay compensation. But the fact that there exists obligation to pay compensation shows that termination of a contract is not as such absolute right.

---

[16] Foighel, supra note 3, p. 192.
[17] Ralston, French-Venezuelan Claims Commission (1906), quoted in Foighel, supra note 3, pp. 190-191.

Ray objects this theory for it confused legal right with naked power and lacked substance. According to him to say that a state can terminate a contract upon compensation is the same as saying that " a legal wrong when bought and paid for becomes a legal right."[18] He further submits that the theory is legally unsupported contention of the power politicians, that it is an effort to legalize national wrong doing which will substitute the rule of force for the rule of law.[19] Both the International Law Association[20] and the Committee on Investments Abroad in Time of Peace[21] (in 1958) repudiated the contention that state taking of alien property in violation of a contract was not a legal wrong.

An important aspect of sovereignty which enables the state to enjoy absolute power, many allege, is the purpose for which the state stands, i.e., protection of public interest. The idea is that a state cannot contract away its power to safeguard welfare of its citizens, that this right always remains reserved. O'Connell declares that abrogation of concessions is lawful in international law as the state is concerned with economic welfare of the public, and that it cannot bind itself to relationships with aliens that might possibly in time derogate from that welfare.[22] By addressing the First Arab Petroleum Congress (1959) Frank Hendryx, a legal adviser in Petroleum and Mineral Affairs in Saudi Arabia, made a statement to the same effect. Referring to the United States, England and France he pointed out that it was the rule of law recognized in these legal systems that the purpose for which governments exist, i.e., protection of public interest,

---

[18] Ray, supra note 1, pp. 457-58.
[19] Ibid., p. 498.
[20] "Report of the International Committee on Nationalization of Property" Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 28.
[21] Ray, supra note 1, pp. 499-50.
[22] D. P. O'Connell, "A Critique of the Iranian Oil Litigation", International and Comparative Law Quarterly (Vol. 4, 1955), London, The Society of Comparative Legislation, p. 267.

requires that the states must be able to override their contractual obligations.[23] The assertion in these views is that a state's unilateral alteration or abrogation of concession agreements in the claimed public interest is proper. Accordingly, this is an argument that it is in line with the accepted law of civilized nations that a state may alter or nullify its existing concession agreements, so long as the action is taken on behalf of public interest. This is a saying that the state is not competent to fetter its future action for this must be determined by the needs of the community when the question arises. That the state cannot by contract hamper its freedom of action in matters which concern the welfare of the state.

This public interest based opinion seems to suffer from limitations. For one thing what constitutes public interest is not defined. This will give rise to abuse on part of the state which claims existence of public interest to breach the contract. For another, it makes untenable assumption that future interests of the public are always unpredictable, and that as such a state's attempt to subject the same to an agreement is a futile exercise. The state is there to protect public interest, including future economic interests of the community. This it can do by committing the public, through its act, to different transactions, one of which is concession agreements. This implies that the state may predict future interests and that it possesses competence to fetter its future action. And the economic development objective seems to necessitate the same.

An otherwise statement of a public interest based view is the *clausula rebusic stantibus* doctrine. The doctrine normally relates to treaties (Art. 62 of the Vienna Convention on Treaties). The doctrine is that fundamental changes affecting the operation of the treaty

[23] Ray, supra note 1, pp. 500-501.

may provide a justification for termination of the treaty. The theoretical justification for the doctrine is said to be found in the right of self-preservation of states.[24]

An argument that the doctrine is equally applicable to concession agreements has been advanced, assuming that the assimilation of a concession agreement to a treaty is possible.[25] Whatever possible the assimilation may be, Sornarajah submits, there is a strong reason for the doctrine being applied to concession agreements. According to him these agreements are so connected with economies of states that the attitude of a state party must be affected by the changing circumstances. [26]

The Aminoil Arbitration (American Indep. Oil Co. (Aminoil) V. Kuwait) presents an instance as to operation of changed circumstances on concession agreements. The tribunal observed that the agreement had undergone changes since the time of its making, and it assessed the effects of these changes in its conclusion: [27]

> *The contract of concession thus changed its character and become one of those contracts in regard to which... the state enjoys special advantages. In relation to Aminoil's undertaking, therefore, the state thus became... an associate whose interests has become predominant.... The faculty of nationalizing the concession could not hence forward be excluded in relation to the regime of the undertaking as it resulted from the sum total of the considerations relevant to its functioning.*

The argument contained in this holding is that though the terms of the agreement might have precluded breach of the contract or taking of the property at the time of making, the changes in the circumstances surrounding the agreement have been such that the

---

[24] M. Sornarajah, The Pursuit of Nationalized Property, Dordrecht, Martinus Nijhoff Publishers (1986), p. 133.
[25] J. Garner, "The Doctrine of Rebus Sic Stantibus and the Termination of Treaties", American Journal of International Law (Vol. 21, 1927), Washington, D.C., Lancaster Press Inc., p. 509.
[26] Sornarajah, supra note 24, p. 133.
[27] Quoted in Sornarajah, supra note 24, p. 134.

host state was no longer restricted from terminating. In doing so, it is admitted, the tribunal was applying the doctrine of intertemporaltiy of law which requires that established legal situations be analyzed in the light of the prevailing legal standards.[28] This amounts to mean that the tribunal was applying the rules of variation of the terms of the contract to be found in many legal systems as a general principle.

The change of circumstances doctrine may also involve a difficulty unless what it means or situations under which it would be applied are precisely defined. Breach of contract by a state is a punishment to an alien partner. If change of circumstances also means improvement in economic situations, why should a party be punished for happening of what is already expected at the time of agreement? Any concession agreement contemplates change. If it is successful, it will produce change. Ray, therefore, strongly reminds that changes in circumstances and economic conditions do not justify alteration or termination of the agreement,[29] that the law does not penalize a party because the venture has produced the results it was designed to produce.

3.2 Doctrines for Respect

The international economic system of the world is an instrument for human welfare. Differential advantage in the possession and use of economic resources exists in states. The possession of raw materials, production facilities and technology varies among states. Therefore, states seek to promote the good life of their citizens by the international flow of capital and by trade and intercourse. It is submitted that maximum wealth and well-being for mankind will be promoted by the joining together of the world's

[28] Sornarajah, supra note 24, p. 134.
[29] Ray, supra note 1, p. 465.

hysical resources with the capital and the skills which are indispensable to their evelopment. [30]

is an economic fact that some countries can export capital, and more countries must mport capital. The latter, if they are to improve the living standard of their people, must ttract substantial investment of capital, skills, managerial and technical assistance from broad. So, we see that there is much interest in a maximum flow of international apital. And it is rightly submitted that international development contracts are a primary neans of implementing that interest.[31] Michael D. Ramsey maintains that governments round the world view private international investment as a critical source of economic levelopment.[32] Conclusion of concession agreements is, therefore, at the very heart of nternational economic development and social advance. Many countries would never chieve the living standards of which they are capable unless foreign nationals were enabled to invest capital and managerial skills.

f concession agreements are of such great import, it will continue to be necessary to protect and secure the international economic order under law. International levelopment contracts in developing nations are characterized by high levels of risk. It s observed that much of the risk relates to government action of the host state.[33] The potential risk deters the investors or makes them demand from the host state higher degree of protection. To attract foreign investment host states need also ways to reduce

---

[30] Lowell C. Wadmond, "The Sanctity of Contract between a Sovereign and a Foreign National", Selected Readings on Protection by Law of private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 148.

[31] Report of the International Committee on Nationalization, supra note 20, p. 33.

[32] Michael D. Ramsey, "Acts of State and Foreign Sovereign Obligations", Harvard International Law

risk. One such solution is to undertake through contractual commitments not to interfere with the investment.

Professor Dunn maintains that aliens at the time of the agreement expect that the government will observe obligations in the contract.[34] He further holds that an individual who contemplates the defeat of contractual expectations will not make such a contract at all.[35] Wadmond submits that as a state has the right to contract, it should be able to uphold such a contract. [36]

The point in these views is that security of concession agreements is an important element of investment. The sanctity of contract between a state and a foreign national is so important. The security vanishes with violation of international contracts. Unilateral repudiation by states of their contracts with aliens hardly promotes the interest in the conclusion of the contract. Parties normally contract in the expectation of performance. It is, therefore, stated that when a state by breaching the agreement upsets that expectation, it violates international law. [37]

We find many other views which hold the action of a host state which goes against parties' expectation unlawful in international law. The Harvard Research on codification of the law governing the treatment of alien interests has viewed the breach of concession agreements as breach of international law.[38] The Preparatory Committee of the Hague Conference for Codification of International Law held alike. The Committee

---

[34] B. Dunn, the Protection of Nations (1932), cited in Wadmond, supra note 30, p. 149.
[35] Ibid.
[36] Wadomnd, supra note 30, p. 148.
[37] Report of the International Committee on Nationalization, supra note 20, pp. 30-31.
[38] Edwin, M. Borchard, "The Law of Responsibility of States for Damage Done in Their Territory to the Person on Property of Foreigners", American Journal of International Law (Vol. 23, 1929), Washington, D.C., The Rumford Press, p. 167.

submitted that the taking of alien contractual rights by a state is a breach of international law.[39]

These views tend to protect the reciprocal expectation of parties that a promise will be kept. Carlston claims that this is an expectation which any system of law must protect, and that as such this protection is a general principle of law universally recognized by civilized states.[40] This is the submission that under international law a state does not have the right to breach a contract with an alien. A state cannot, through its municipal action, vary its obligations under international law.

A response by the Committee on the Nationalization of Property by the American Branch to the Questionnaire of the International Committee on Nationalization[41] reflected a similar view, that international law gives respect to concession agreements. In its response to the question relating binding character of concession agreements, the Committee held the view that international law requires that these agreements be respected.[42] The Committee emphasized that a concession granted may not lawfully be repealed by the state whether or not compensation is paid,[43] that the breach by a state of concession granted to an alien is a breach of international law.

The position of the United States as to the binding character of concession agreements is moreover, to be found in one of its famous cases (Perry V. United States) and in the

---

[39] The League of Nations Document (1929), cited in the Report of the International Committee on Nationalization, supra note 20, p. 30.
[40] Kenneth S. Carlson, "Concession Agreements and Nationalization", American Journal of International Law (vol. 52, 1958), Washington, D.C., Lancaster Press, Inc., p. 261.
[41] The Committee was created by the American Branch of International Law Association to Study the problem of internationalization of the property of aliens. The committee was composed of fifteen lawyers experienced in international law. The responses express the view of the committee as a whole.
[42] Report of the International Committee on Nationalization, supra note 20, p. 44.
[43] Ibid., p. 46

opinion of Alexander Hamilton, the first Secretary of the Treasury of the United States. In the case it was held that the United States is as bound by its contracts as are individuals.[44] When the United States makes contracts with individuals, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments. Hamilton stated that when a government enters into a contract with an individual, it renounces its constitutional authority to legislate as to the matter of the contract.[45] He went on to elaborate that the state's promises may be considered as excepted out of its power. [46]

An English court has also reached a similar conclusion in Robertson V. Minister of Pensions (1948). It held that the Crown is bound by its express promises as much as any subject, and that the defence of executive necessity is of limited scope. [47]

Wadmond maintains that these views represent the respective positions of the two legal systems as to the sanctity of concession agreements in international law.[48] And he argues that, having regard to the extensive influence these systems have on other national systems of the world, the cases are important evidence of what the relevant general principles of law are.[49] Wadmond further submits that customary international provides that contracts between a state and a foreigner are binding upon both parties. [50]

In the Texaco Overseas Oil Petroleum Company V. Libyan Arab Republic the arbitrator not only observed that a state may in the exercise of its sovereignty undertake

[44] Wadmond, supra note 30, p. 149
[45] Ibid., p. 150
[46] Ibid.
[47] Ibid., p. 151
[48] Ibid.
[49] Ibid.
[50] Ibid.

international commitment with a private party but also maintained that a state shall be bound by it. He stated the effect of such commitment:[51]

> *The result is that a state cannot involve its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty, and cannot through measures belonging to its internal order make null and void the right of the contracting party.*

The claim here is that sovereignty as known in international law does not prohibit the effectiveness of contractual obligations or the grant of irrevocable rights. When a state contracts with foreigners, it undertakes to respect and perform the agreement. If the contract is abrogated by future act of a state, then there is violation of this obligation. Thus, if they are to bind the parties, concession agreements shall have respect in international law. This is what the here-in-above explained views evidence.

Some even equate concession agreements with treaties to justify their binding character. The American Committee on Nationalization of Property stated that the obligation of a state to observe a treaty embrace the field of contractual interests.[52] In the view of the Committee the contractual obligations freely assumed by a state are no less binding than its treaty obligations. Professor de La Pradelle, Rapporteur of the Institute of International Law and who was preparing a draft law on nationalization of property (1952), advanced an instrument that provided to the effect that taking of a property by a state should respect obligations validly entered into, whether by treaty or by contract. [53]

---

[51] The Award quoted in Waelde and Ndi, supra note 7, p. 287.
[52] Report of International Committee on Nationalization, supra note 20, p. 28.
[53] Ibid., p. 30.

The view for respect of concession agreements in international law is also found in different arbitral awards. The tribunals considered the unilateral abrogation by a state of its contract unlawful. In the Shufeldt case [54] an American citizen was the assignee of the concession with life of ten years, granted by the Government of Guatemala. After six years the Government abrogated the concession by a legislative measure. And the arbitrator found the abrogation unlawful. The holding of a similar effect was made in Radio Corporation of America V. China.[55] The principal issue in the case was whether the Radio Traffic Agreement of 1932 between the Chinese Government and Mackay Radio Company constituted a breach of the 1928 Radio Traffic Agreement concluded between the same government with the Radio Corporation of America. Apart from deciding on the issue the tribunal found that the Chinese Government can sign away a part of its liberty of action. The finding implies the rule that promise of a state is binding in international law. A view taken in the arbitral award relating to the dispute between the Government of Saudi Arabia and the Arabian American Oil Company in 1958 is also relevant. The tribunal said: [56]

> *By reason of its sovereignty within its territorial domain, the state possesses the legal power to grant rights which it forbids itself to withdraw before the end of the concession with the reservation of the clauses of the concession agreement relating to its revocation. Nothing can prevent a state, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the concessionnaire irretractable rights.*

These arbitral decisions on their part try to show that binding character of concession agreements has its place in international law. The position of international law is for

---

[54] "Decision of the Arbitrator in the Claim by the United States of American on behalf of P. W. Shufeldt Against the Republic of Guatemala", American Journal of International Law (vol. 24, 1930), Washington, D.C., The Rumford Press, p. 799.

[55] E.I. Nwogugu, The legal Problems of Foreign Investment in Developing Countries, Manchester University Press (1965), p. 175.

[56] The Award, quoted in Nwogugu, supra note 55, p. 175.

respect of these agreements. Breach of transactions which have force in international law is, therefore, an international wrong act. The awards reveal that a state by virtue of its sovereignty possesses the capacity to exercise functions important to meet public interest. One of these is to engage in international contracts. This assumes state's competence not only to sign agreements but also to be bound by its promise therein. The very purpose of entering into such engagements in fact implies their binding effect. Now we shall see different theories or principles as to the binding nature of concession agreements.

3.2.1 Pacta Sunt Servanda

Pacta sunt servanda is a principle which has developed in connection with treaty obligations of states. Kissam and Leach maintain that there is a universal agreement that under international law states are bound to perform their treaties with other states and to carry out in good faith the obligations assumed thereunder.[57] It is this assertion that obligations assumed shall be respected which is termed as *pacta sunt servanda.*

Pacta sunt servanda is understood as a requirement of performance of agreement according to its terms.[58] The doctrine has been interpreted to mean that every international agreement binds the parties to it and requires them to perform in good faith. [59] It simply means that agreements are binding. The idea is that an agreement which has been performed by a party or which a party desires to perform should be performed by another.

---

[57] Kissam and Leach, supra note 4, p. 396.
[58] Danielle Mazzini, "Stable International Contracts in Emerging Markets", Boston University International Law Journal (vol. 15, 1997), p. 344.
[59] Ibid.

The rationale behind doctrine of *pacta sunt servanda* seems that of achieving orderly and economically developed society. Fatouros admits that this purpose has the moral and legal force as he states that any action of the state which results in violation of agreements is a contravention of the legal and moral principle[60] The importance of the principle *pacta sunt servanda*, that agreements be respected, is clearly indicated in statements by Wehberg: [61]

> *If a contract, validly concluded, were not binding, then international law would be deprived of a decisive foundation and a society of states would no longer be possible. International law, and with it also the sanctity of contracts, results by a natural necessity from the inevitability of social intercourse…. In the system of international law, which stands over states, the sanctity of contracts is not to be rationalized away.*

As such the principle of sanctity of contracts is an essential condition of the life of any social community. That no economic relations can exist without the principle *pacta sunt servanda*. For this would render the economic relations uncertain. Respect for agreement, it goes without saying, is, therefore, of capital importance to meeting the purpose therein.

Bourquin states that the principle *pacta sunt servanda* is universally accepted.[62] For Jenks the concept of respect for agreements freely concluded is such an important principle of international law that it is common to most legal system of the world.[63] Owing to such universality *pacta sunt servanda* can be regarded as a general principle of law. Thus, Wehberg points out that *pacta sunt servanda* is a part of customary law

---

[60] A.A. Fatouros, Government Guarantees to Foreign Investors, New York, Columbia University Press (1962), p. 262.
[61] Wehberg, supra note 8, p. 780.
[62] Maurice Bourquin, "Arbitration and Economic Development Agreements", Business Lawyer (Vol. 15, 1960), Chicago, Banking and Business Law of the American Bar Association, p. 862.
[63] Jenks, The Common Law of Mankind (1958), Cited in Nwogugu, supra note 55, p. 185.

as well as one of the general principles of law recognized by civilized nations.[64] He further asserts that "it is easily understandable that no arbitral tribunal has ever rejected the rule of *pacta sunt servanda*, or even thrown doubt on it."[65] by such an assertion Wehberg seems to have accepted that application of the principle has been repeated in the life of nations, and that *opinio juris sive necessitatis* is given. His words that the principle has been used from time immemorial and that states have always taken the view that the principle corresponded to their conviction reveal such belief. [66]

Sornarajah, however, doubts the value of the doctrine of sanctity of contracts as a general principle of law.[67] His argument is that state intervention to regulate the terms of contracts has become common in the welfare state. And increasing regulation of the economy has considerably eroded the notion of sanctity of contracts, for the sate will not be limited by its own contractual dealings.

As a general principle of law, one may submit, *pacta sunt servanda* applies to interstate agreements and to contracts between private persons according to the municipal law of states. But concession agreements belong to neither of these categories. Whether the principle *pacta sunt servanda* applies to these agreements is, therefore, the issue.

In the foregoing sections in some respects concession agreements have been identified with interstate agreements. Similar analogies are also made here. Thus, a learned author emphasizes the similarity between interstate agreements and concession agreements: [68]

---

[64] Wehberg, supra note 8, p. 781.
[65] Ibid.
[66] Ibid., p. 782.
[67] Sornarajah, supra note 24, p. 110.
[68] D. P. O'Connell, "Legal Issues in the Persian Oil Dispute", quoted in Fatouros, supra note 60, p. 263.

> *A state cannot unilaterally abrogate its treaties with other states without violating international law, and there is no real difference in this respect between a treaty and a concession, except that the latter is an agreement, not between states, but between a state and a person of private law.*

Wehberg who surveyed the place of *pacta sunt servanda* in international law concluded that "... the principle is valid exactly in the same manner, whether it is in respect of contracts between states or ... between states and private companies."[69] He emphasizes that the economic relations between states and foreigners cannot exist without the principle *pacta sunt servanda*, and that practice has accepted this.[70] Kissam and Leach also consider the principle *pacta sunt servanda* as important basis for holding a sovereign internationally responsible for a breach of a concession agreement.[71]

In the case of Losinger and Co., Switzerland contended that the principle *pacta sunt servanda* applies not only to interstate agreements but also to concession agreements.[72] On the basis of similarity of treaties and concession agreements the Swiss view was characterized by the Committee on the Study of Nationalization of the American Branch of the International Law Association as "unassailable."[73] A committee of the International Bar Association at its 1958 meeting proposed that international law recognizes the application of the principle *pacta sunt servanda* to engagements of states towards nationals of other states.[74] The Draft Convention on the Protection of Foreign Property (Article 2) provides that "Each party shall at all times ensure the

---

[69] Wehberg, supra note 8, p. 786.
[70] Ibid.
[71] Kissam and Leach, supra note 4, p. 396.
[72] The Contention is cited in F. A. Mann, "State Contracts and State Responsibility", American Journal of International Law (vol. 54, 1960), American Society of International Law, New York, p. 577.
[73] Kissam and Leach, supra note 4, p. 398.
[74] The Proposed Resolution of the Open Committee Meeting on Protection of Investments Abroad in Time of Peace, International Bar Association, Seventh Conference (1958), cited in Kissam and Leach, supra note 4, p. 399.

observation of undertakings given by it in relation to property of nationals of any other party." It is obvious that this article is intended to cover concession agreements.

These views tell us that the doctrine of *pacta sunt servanda* would be equally valid in case of concession agreements. As a principle of international law *pacta sunta servanta* is not applicable only to interstate agreements. It also governs contracts between states and private persons (including companies). When a state contracts with foreign investors there is an obligation to respect and observe the agreement.

The proposition that concession agreements should be regarded in the same manner as treaties, and hence governed by international law, is both logical and desirable. That promises are of international scope, reliance is placed on those promises and that obligation to perform the promises should be the same are common elements of the two types of agreements. Moreover, concession agreements should also be performed under the rules that can ensure predictability of the result-rules of international law. This is otherwise explained in terms of *pacta sunt servanda*, a principle which occupies an important place in the system of law governing contracts between states and foreign nationals. [75]

Application of *pacta sunt servanda*, the principle which has been developed in relation to treaty obligations, to concession agreements has been objected by some writers. The criticism has been made that, by applying the rule of *pacta sunt servanda* to concession agreements, the distinction between state and private agreements is blurred and the latter are elevated to treaty level. True, application of the principle to concession

[75] Ray, supra note 1, p. 487.

agreements breaks down such distinction in that it would engage international responsibility for breach of these agreements.

Fatouros holds that the view for application of *pacta sunt servanda* to concessions, even it may seem attractive, is doubtful both in practice and theory, for the analogy between states and individuals or between international law and municipal law is not proper.[76] According to him the modern state is a highly complex unit whose processes and functions have little similarity to those of individuals. Furthermore, the fact that municipal law has reached a stage of maturity whereas international law is at its earlier stage makes the two contrasting as to their stages of development.

Sornajajah also objects the view on the ground that *pacta sunt servanda* is meant to protect the limitation of sovereignty of parties resulting from the mutual surrender of sovereignty in treaties.[77] The idea is that *pacta sunt servanda* has as its basis limitation of sovereignty on part of both parities. Such a mutual surrender of sovereignty does not exist in the case of concession agreements between states and foreign investors. The conclusion, thus, is that assimilation of concession agreements to treaties by ignoring the important differences is not sound.

Still another ground of objection relates to capacity of alien corporations or individuals to conclude international agreements. The point is that application of the principle *pacta sunt servanda* to concession agreements gives to the latter treaty (international agreement) status. And this in turn implies capacity of individuals or corporations to

[76] Fatouros, supra note 60, p. 266
[77] Sornarajah, supra note 24, p. 109.

acquire international rights or to assume international obligations, or, in other words, to conclude international agreements, which they naturally lack. [78]

These objectionist views as to application of *pacta sunt servanda* to concession agreements mainly depended on the difference in character of parties to treaties and concession agreements. The character of the parties should not be a factor to determine analogy between the two types of agreements. The purposes sought and expectations implied in the agreements are, instead, relevant aspects on which the possibility of assimilation of the two agreements should be based. Concession agreements are no less important means of achieving economic development than interstate agreements, that there exists similarity in purpose between the two. Parties to both types of agreements expect that promises in the agreement be performed. These similarities justify the analogy, that the principle *pacta sunt servanda*, which has its origin and development in relation to treaties, be applied to concession agreements.

3.2.2 Acquired or Vested Rights

The arguments against the right of a state to abrogate a concession contract have been put on several grounds. One of such argument is based on the principle of acquired or vested rights. Thus, a concession which has validly come into existence has been called vested private right, and has been considered to be under the protection of international law against breach on the part of the grantor. [79]

---

[78] Ibid.

[79] Schwarzenberger, The Protection of British Property Abroad (1952), cited in Kissam and Leach, supra note 4, p. 394.

It has been said that the scope of acquired rights must depend largely upon judicial elaboration and decision, for the content of the concept cannot be defined easily.[80] The essence of the principle of acquired rights seems to have been, however, reflected in the words of Kaeckenbeeck: [81]

> *However variously defined, the notion of the vested rights has in legal theory and in municipal law been consistently resorted to for solving the ever-recurring difficulties which arise out of the collision of laws in respect of time. In this connection the principle of respect for vested rights appears, so to say, as the other side of the principle of non-retroactivity of laws.*

The words make it clear that the acquired rights principle refers to an imposition on states the obligation to respect those rights once they have become acquired. The concept of acquired or vested rights deals specifically with sanctity of property rights obtained under a particular system of law.[82] The idea is that once property rights have been acquired under the existing law, it cannot be destroyed by a later change of that legal system.

The principle is said to be part of international law. Nwogugu submits that the acquired rights principle has secured an established place among international legal principles and is recognized and applied by international tribunals.[83] Jennings also makes an assertion to the same effect that the view that the principle has formed part of public international law has received the sanction of numerous authorities including the Permanent Court of International Justice and is hardly open to question.[84] The Permanent Court of International Justice held that the property interests of the alien are

---

[80] R. Y. Jennings, "State Contracts in International Law", The British year Book of International Law (vol. xxxvii, 1961), London, Oxford University Press, p. 177.
[81] Ibid.
[82] Nwogugu, supra note 55, p. 177.
[83] Ibid., p. 178.
[84] Jennings, supra note 80, p. 178

protected under international law in the sense that the principle of vested rights forms part of international law.[85] O'Connel states that there is little doubt that the respect for acquired rights is a principle well-established in international law.[86] McNair maintains that concessions should be governed by the general principles of law recognized by civilized nations, and that one of these is the principle of respect for vested or acquired rights. [87]

The submission in these views is that respect for property, respect of acquired rights, these are principles of international law. In return of their subjection to the system of a host state, foreigners are entitled to count upon the legal protection and guarantees under the cover of which they came into the country and acquired their rights.

This principle of acquired property rights has been equally applied to contractual rights of the alien. McNair submits that the principle has frequently been applied by international tribunals to the rights acquired under concessions.[88] Jennings also maintains that there exists good authority in favour of the view that "acquired rights are not confined to the notion of property in its narrowest sense, but also include rights derived from contract or concession."[89] The view here is clear that the rights of exploitation emanating from concessions are vested rights entitled to legal protection in international sphere. As such viewed simply as a property interest and as a problem in the protection of private property abroad, concession agreements are considered to fall under the rule that the property of aliens shall not be taken.

---

[85] Case Concerning Certain German Interests in Polish Upper Silessia (1926), cited in Carlston, supra note 40, p. 268.
[86] D.O. O'Connell, The Law of State Succession, London, Cambridge University Press (1956), p. 99.
[87] Q. C. McNair, "The General Principles of Law Recognized by Civilized Nations", The British year Book of International Law (Vol. xxxiii, 1957), London, Oxford University Press, p. 11.
[88] Ibid., p. 19.
[89] Jennings, supra note 80, p. 178.

Jennings argues that the notion of acquired rights defined in relation to property explains as to why contractual rights should also fall under the protection of international law.[90] The effectiveness of contractual obligations in concession agreements, Nwogugu states, have strong roots in international legal principles relating to the protection of private property.[91] The rights derived by private investors under concession agreements are property rights which are acquired or vested and so entitled to international law protection.

The International Law Association in its forty-eighth conference (1958) adopted a resolution which declared that the binding force of concession agreements is also based on the principle of acquired rights. The statement reads: [92]

> *... the principles of international law establishing the sanctity of a state's undertakings and respect for the acquired rights of aliens require that the parties to a contract between a state and an alien are bound to perform their undertakings in good faith.*

The Permanent Court of International Justice held that the interests involved in a concession are subject to international protection on the basis of principle of respect for vested rights.[93] It was also said in the Aramco Arbitration Award (1958), the dispute which arose between the Government of Saudi Arabia and the Arabian American Oil Company, that the concessionaire's rights constituted acquired rights. The contention of the company was that the Government by entering into another agreement of the same type with another company made its contractual rights ineffective. The arbitral tribunal in upholding the submission of Aramco observed: [94]

---

[90] Ibid., p. 180.
[91] Nwogugu, supra note 5, p. 177.
[92] Quoted in Martin Domke, "Foreign Nationalization: Some Aspects of Contemporary International Law", American Journal of International Law (Vol. 55, 1961), New York, American Society of International Law, p. 602.
[93] Case Concerning ... German Interests, Supra note 85, p. 268.
[94] The Award, quoted in Nwogugu, Supra note 5, p. 179.

> *In its capacity as first concessionaire, Aramco enjoys indeed exclusive rights which have the character of acquired or vested rights and which cannot be taken away from it by the Government by means of a contract concluded with a second concessionaire, even if that contract were equal to its own contract from a legal point of view. The principle of respect for acquired rights is one of the fundamental principles both of public international law and of the municipal law of most civilized states.*

The case makes it clear that the principle of respect for acquired rights prevents the state from derogating from its undertaking. Valid contracts bind both parties and must be performed. When one party has granted certain rights to the other contracting party, it can no longer dispose of the same rights in favour of another party. Having considered that Aramco's contention was true, the Arbitration Tribunal found that the Company was legally protected by the principle of acquired rights.

The special relation of the principle of acquired rights to concession agreements was emphasized in the decision of the Permanent Court of International Justice in the Oscar Chinn Case.[95] The transport business in which Oscar Chinn, the British subject, was engaged in Belgian Congo territory was given to a Belgian Company by the Belgian Government. The British Government claimed, on behalf of its subject, that the action of the Belgian Government was contrary to the customary rules of international law for the protection of acquired rights of foreigners. By way of rejecting the British claim the Court based the ruling on the fact that Chinn had no concession from the Belgian Government and as such did not possess a vested right.

All these show that the contractual acquired right is broader than the acquired property right. Chinn lost his claim because his right neither related to property nor arose from a

[95] The decision is partly produced in Q. C. McNair, "The Seizure of Property and Enterprises in Indonesia", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 589.

concession agreement. Consequently, the principle of acquired rights couldn't apply to it.

The special importance of the principle of acquired rights is evident in situations where the principle of *pacta sunt servanda* cannot be applied to protect contractual rights. McNair states that this happens when there is a change of sovereignty on the part of the grantor state because of, for example, the territory on which the contractual right is to be exercised being passed to another state.[96] In this situation the survival of the concession is secured, McNair maintains, because of respect for the principle of vested rights.[97] His view seems to have been supported by well established practice as he cites several instances to substantiate the position. [98]

To conclude my observation as to the issue of respect of concession agreements at international sphere, the doctrinal debate on the issue, without question, has given rise to divergence of views. No single dominant view seems to have emerged so far. The cases illustrate lack of consistency in international jurisprudence as to respect for concessions. Waelde and Ndi, however, rightly claim that the majority of scholarly views and arbitral awards have been made in favour of respect of contracts.[99] Hans Wehberg also maintains that the newer theory of international law adheres to the validity of the principle *pacta sunt servanda*.[100] Danille Mazzini argues that to ensure continuance of foreign investors to contract with developing countries, the later must abide by the

---

[96] McNair, supra note 87, p. 22
[97] Ibid.
[98] In all of the instances the considered, concessions survived the change of sovereignty of the grantor because they constituted vested rights.
[99] Waelde and Ndi, supra note 7, p. 242.
[100] Wehberg, supra note 8, p. 782.

international contract norm of *pacta sunt servanda*.[101] For Wehberg this is hardly surprising, since any other view would amount to denying the existence of international economic relations.[102] The sanctity of contracts results by a natural necessity from the inevitability of social intercourse. Man likes to plan with some measure of certainty. He, therefore, wants to deal with those upon whom he can depend. That the principle of *pacta sunt servanda* became embedded in man kind's rules of life, Ray holds, was not, therefore, an accident. [103]

3.3 Are all Breaches Unlawful?

It has already been noted that concession agreements are binding as per the principles of *pacta sunt servanda* and acquired rights. The question now is if these principles apply without qualification or exception. This is to see if there exist cases where a state is entitled to change a contractual relationship with an alien.

Jennings submits that no mature law of contract can be absolute,[104] that it cannot be understood without qualification. The idea is that whether or not an alleged breach of contract amounts to a breach of international law depends upon a number of variants, such as the circumstances or even the motives of the state action with respect to the contract. It is submitted that action taken by a state to ensure public safety or public health, for example, would not necessarily result in an international wrong, [105] even though the action might modify the contractual regime. The view is that it can hardly be the case that the proper law of every contract is frozen into immobility at the moment of

---

[101] Mazzini, supra note 58, p. 343
[102] Wehberg, supra note 8, p. 782.
[103] Ray, supra note 1, p. 514
[104] Jennings, supra note 80, p. 179.
[105] Ibid.

the conclusion of the contract. The proposition for respect of concessions remains to be a presumption leaning against the existence of any right of unilateral termination, which presumption may be rebutted in some cases. Neither the principle of acquired rights nor the principle of *pacta sunt servanda* is therefore to be regarded as being necessarily absolute or unconditional in its application.

3.3.1 Excused Breach

The basic function of contracts is to secure the original purposes of the parties against later prejudicial shifts of purpose. Consequently, the law makes it difficult for a contracting party to escape contractual obligations. As both parties are bound to observe their promises, a state should not change its law in a way that adversely affects the foreign contracting partner. This is what the principles of respect of concessions state as are discussed in the foregoing sections.

The strict absoluteness approach, prohibiting alternation of the concession agreement for any reason except by mutual consent, protects foreign investors from their sovereign contracting partner's action. Strict absoluteness of contractual obligations, it is stated, may, however, no longer be the dominant theory of construction.[106] The trend is for flexibility of concession agreements, that there shall be a room for excuse of non-performing party. Failure to observe a contractual obligation under some exceptional circumstances would no more be an international wrong.

[106] Ramsey, supra note 32, p. 45.

It is argued that sanctity of contract has never been treated as an absolute and unqualified principle.[107] Definition of those circumstances the existence of which justify derogation from the principle remains to be an important task. Ray generally states that the law will excuse non-performance of contractual obligations in only a small number of cases.[108] Lauterpacht holds a similar view that:[109]

> *Although the protection of the right to rely upon the contract is fundamental, there is nevertheless a relatively small segment of cases in which the law will recognize that the contract has, as a result of unforeseen change of circumstances, failed to realize the true will of the parties and that it cannot be maintained wholly or in part.*

The catalogue of excuses, it is maintained, includes contractual reservations of a right of non-performance, refusal of performance on the part of another party, impossibility of performance, protection of public interest and change of circumstances.[110] The contracting parties may expressly confer on either party the power to modify or abrogate the agreement under certain conditions. In such cases the power of abrogation or modification is an express term of the contract. If it is exercised by a party in accordance with the stipulated conditions of the contract, the other contracting party cannot challenge its validity.[111] It is also argued that if a party refuses to abide by a contract because of the prior breach by another contractor, the former hardly could be said to violate international law.[112] This seems to have been justified on the basis of reciprocity principle of contractual obligations. Again, if performance is rendered impossible because of happening of an event, a party against whom such impossibility

---

[107] R. Geiger, "The Unilateral Change of Economic Development Agreements", International and Comparative Law Quarterly (Vol. 23, 1974), London, The Society of Comparative Legislation, p. 73.
[108] Ray, supra, note 1, p. 507.
[109] Lauterpacht, Function of Law in the International Community (1933), quoted in Ray, supra note 1, p. 507.
[110] Ray, supra note 1, p. 507.
[111] Nwogugu, supra note 55, p. 187.
[112] Wadmond, supra note 30, p. 153.

occurred will not be required to comply with the obligation. This is so because a party is put under a situation in which he cannot observe his promise even if he wishes. Wadmond, thus, maintains that a government would not violate international law by not performing its contract because of the onset of war conditions or of some great natural catastrophe.[113]

More controversy exists with respect to the essence of the other two cases of exception, public interest and change of circumstances. Although investment contracts are legally binding and protected by international law, now we are considering situations in which the right of contracting party, such as the state, to disturb the contractual relationship is generally recognized. One of these is action for the public interest purpose. The idea is that state measures affecting contractual rights of aliens remain lawful if they serve the purpose of public interest. This is a rule, Fatouros concedes, mentioned by most writers on the subject and found in the dicta of several decisions of international tribunals.[114] Asante maintains that the civil and the common law systems all recognize the principle that concession agreements may be unilaterally modified by a state in certain circumstances by virtue of the government's sovereign rights.[115] He is, thus, impliedly submitting that such a rule has acquired the status of general principle of law. Nwogugu also admits that the exercise of this right is common in the practice of states.[116] Mann states that state measures of legislation or executive action put into force for the benefit of the community at large are not unlawful even if they infringe upon

---

[113] Ibid.
[114] Fatouros, supra note 60, p. 247.
[115] Samuel K. B. Asante, "Sanctity of Contractual Relations in the Transnational Investment Process", Third World Attitudes towards International Law – an Introduction, Boston, Martinus Nijhoff Publishers (1987), p. 698.
[116] Nwogugu, supra note p. 55, 187.

individual contractual rights.[117] He elaborates this assertion: that a state shall not be responsible for injuries caused to an alien by the non-performance of its obligations stipulated in a contract where its action is required for the protection of public safety, health, morality or welfare in general.[118]

These views reveal that a state legislation passed for the protection of public health, public safety or general welfare does not amount to international wrong even though it might have affected contractual right of an alien. That nothing can restrict the power of the state to protect public health, public morals or public safety. States possess the right to pass legislation for the protection of public interest which may affect the contractual right of another party. When such laws are passed in "*bona fide* public interest", they are not regarded as the wrongful acts.[119]

The need for the rule under, consideration seems evident for time may come when interest to protect values described hereinabove as "public interest" would prevail over contractual interest. Problem of application of the rule is also equally evident as their exists no precise definition of what constitutes "public interest". International law does not give any detailed definition of the interest that may be considered as public for the purpose of justifying intervention to contractual situation.[120] As such the rule may be subjected to abuse by states. Fatouros suggests the limited application of the rule as he states, "The interest involved should be understood as one of the general public and not as a mere financial interest of the state treasury."[121] He tries to be more precise, that the public interest might be more immediate, as in he case of measures of protection of

[117] Mann, supra note 72, p. 583.
[118] Ibid., p. 591.
[119] Nwogugu, supra note 55, p. 187.
[120] Fatouros, supra note 60, p. 248.
[121] Ibid.

the public health or of public safety, or less so, as in the case of measures involving the general welfare of the public.[122] Generally, the rule should be understood so as to strike the balance between both interests: the presumed intention of the parties to be bound by the agreement and the power of the state to take care of important interests of the public.

State measures which are dictated by reasons of public interest should also be non-discriminatory, absence of discrimination is considered as another requirement for the legality of state measures affecting the contractual rights of aliens. The idea is that state measures affecting unfavorably the interest of aliens because of their being aliens are unlawful in international law. The rule is considered as being widely accepted by almost all writers and in the decisions of international tribunals.[123] This is rightly so because discrimination between aliens and nationals or between an alien and another may disprove the alleged public interest in a state's measure. Discrimination consists in the differential and unfavorable treatment of aliens as compared to nationals or of a specific group of aliens as compared to other aliens.

Another, still more controversial, way-out relating to contractual obligations is the change of the circumstances of the contract. The idea has it source in the law of treaties. It is referred to as *clausula rebus sic stantibus* doctrine. The doctrine is that fundamental changes affecting the operation of the treaty may provide a justification for termination of the treaty.[124] The doctrine is stated in Article 62 of the Viena Convention on Treaties.

---

[122] Ibid.
[123] Ibid., pp. 249-250.
[124] Sornarajah, supra note 24, p.133

the public health or of public safety, or less so, as in the case of measures involving the general welfare of the public.[122] Generally, the rule should be understood so as to strike the balance between both interests: the presumed intention of the parties to be bound by the agreement and the power of the state to take care of important interests of the public.

State measures which are dictated by reasons of public interest should also be non-discriminatory, absence of discrimination is considered as another requirement for the legality of state measures affecting the contractual rights of aliens. The idea is that state measures affecting unfavorably the interest of aliens because of their being aliens are unlawful in international law. The rule is considered as being widely accepted by almost all writers and in the decisions of international tribunals.[123] This is rightly so because discrimination between aliens and nationals or between an alien and another may disprove the alleged public interest in a state's measure. Discrimination consists in the differential and unfavorable treatment of aliens as compared to nationals or of a specific group of aliens as compared to other aliens.

Another, still more controversial, way-out relating to contractual obligations is the change of the circumstances of the contract. The idea has it source in the law of treaties. It is referred to as *clausula rebus sic stantibus* doctrine. The doctrine is that fundamental changes affecting the operation of the treaty may provide a justification for termination of the treaty.[124] The doctrine is stated in Article 62 of the Viena Convention on Treaties.

---

[122] Ibid.
[123] Ibid., pp. 249-250.
[124] Sornarajah, supra note 24, p.133

Even if it is admitted that the doctrine has no definition upon which a majority of writers agree, the definition which is considered as to have been accepted by some authors states that: [125]

> *The obligations of a treaty terminate when a change occurs in those circumstances which existed at the time of the conclusion of the treaty and whose continuance formed, according to the intention or will of the parties, a condition of the continuing validity of the treaty.*

The principle of *clausula rebus sic stantibus* is taken as laying down that a vital change of circumstances after the conclusion of a treaty may bring about its dissolution.[126] The Harvard Research emphasized that such dissolution would be made only when "the state of facts the existence of which was envisaged by the parties as a determining factor moving them to undertake the obligations stipulated has been essentially changed."[127] One can also find a kind of restrictive definition of the doctrine in Brierly's words:[128]

> *What puts an end to a treaty is the disappearance of the foundation upon which it rests; or if we prefer to put the matter subjectively, the treaty is ended because we can infer from its terms that the parties, that though they have not said expressly what was to happen in the event which has occurred, would, if they had foreseen it, have said that the treaty ought to lapse.*

The expressions used in foregoing definitions to qualify the change of circumstances condition are not the same, that there is no agreement a to the definition of the doctrine. Yet, one thing is clear; it is not every change of circumstances that will put an end to the obligations of a treaty. The *clausula* is not a principle enabling the law to relieve from

---

[125] Hill, "The Doctrine of 'Rebuc Sic Stantibus' in International Law" (1934), quoted in Ray, supra note 1, p. 509.
[126] Nwogugu, supra note 55, p. 186.
[127] Bourquin, supra note 62, p. 866.
[128] J. L. Brierly, The Law of Nations, Oxford University Press, Oxford (1963), pp. 245-46.

obligations merely because new and unforeseen circumstances have made them unexpectedly burdensome to the party bound, or because some considerations of equity suggests that it would be fair and reasonable to give such relief.

The doctrine does not, however, seem to have received attention in the practice of courts and tribunals. Brierly maintains that there is no instance in which the application of such rule has been admitted by parties to a controversy, or in which it has been applied by an international tribunal.[129] Ray declares that there has been no termination of a treaty on the basis of the rule under consideration.[130] Briggs has also stated on his part that the doctrine has scarcely been established as a rule of international law. [131]

Consequently, in practice the better view, Nwogugu maintains, is that there is no unilateral right to terminate an agreement because of alleged change of circumstances.[132] The International Court of Justice, it is said, has been reluctant to use the doctrine as the basis for justifying the termination of treaties.[133] This may be because the doctrine lacks precise definition. It is also said that the doctrine poses serious dangers to the security of treaties,[134] which danger may possibly relate to its imprecise definition.

All those limitations will follow it if this treaty originated doctrine is to be applied to concession agreements. Sornarajah strongly asserts that there is an important case for

---

[129] Ibid., p. 244.
[130] Ray, supra note 1, p. 510.
[131] Herbert W. Briggs, "The Attorney General Invokes Rebus Sic Stantibus", American Journal of International Law (vol. 36, 1942), Washington, D.C., Lancaster Press Inc., p. 90.
[132] Nwogugu, supra note 55, p. 186.
[133] Sornarajah, supra note 24, p. 133.
[134] Ibid.

the doctrine being applied to concession agreements.[135] He reasons out that the changed circumstances must affect the attitude of the state which is party to the agreement. Nwogugu also concedes that concession agreements may be abrogated by change of circumstances "which fundamentally affects" the enforcement of contract in its original form.[136]

These are merey a kind of policy arguments for the ought to be law on the subject. There is no sufficient authority or established practice as to show the existence of such rule of international law. Ray, therefore, states with emphasis that the doctrine "is not now and never has been authority for the unilateral alteration or abrogation of a contract by a state."[137]

3.3.2 Arbitrary Breach

By arbitrary breach I mean the breach of concession agreement which is prohibited in international law, or which entails international responsibility. In relation to the issue of respect for concession agreements we have seen that the rule is that agreements are binding. It follows, therefore, that any breach of agreement is unlawful in international law, and hence is arbitrary breach. If the state makes a legislation which interferes with contractual rights of another party, or if it otherwise fails to perform its obligation, principles of *pacta sunt servanda* and acquired rights outlaw such an action or omission. It has been stated that the breach of contractual rights is an arbitrary act which of itself engages a state's responsibility under international law.[138] The idea is that international responsibility is involved whenever a state uses its governmental

[135] Ibid.
[136] Nwogugu, supra note 55, p. 186.
[137] Ray, supra note 1, p. 509.
[138] Wadmond, supra note 30, p.153.

power to defeat the expectations of the parties to the contract. Professor Eagleton argues that the view that all breaches of contract on the part of a state are internationally illegal is supported by practice.[139]

This rule, however, is not absolute. Some exceptional circumstances necessitate qualification of the rule, that there are situations in the existence of which the breach of a contract may not be regarded as unlawful or arbitrary act. Wadmond maintains that every non-fulfillment of a contract on the part of the government may not be claimed to create a presumption of an arbitrary act in violation of international law.[140] In fact, we have considered in the previous sub-section that some kinds of breaches of concession agreements are excused under international law. It is not every non-fulfillment of contract that is taken as arbitrary breach. Therefore, it suffices to say that arbitrary breach refers to all sorts of breach except those which are excused.

Thus, talking about arbitrary breach is the same as talking about excused breach, but from a different direction. Here I am not to mention each and every possible instance of arbitrary breach, which is both difficult and unnecessary. The idea of arbitrary breach is explained simply by reference to conditions of excused breach.

If follows from the rules of excused breach (which are explained in the foregoing sub section) that any act of breach which is not justified on the basis of either of those circumstances is arbitrary breach. By referring to the grounds of excused breach Wadmond explains arbitrary breach as follows:[141]

---

[139] Eagleton, The Responsibility of States in International Law (1928), cited in Wadmond, supra note 30, p. 169.
[140] Wadmond, supra note 30, pp. 158-159.
[141] Ibid., p. 156

> *I submit that where a government, in an action which is not justified by impossibility of performance or the prior essential breach of the alien, employs its sovereign power to defeat the expectations under which the parties contracted, the government stands in breach of international law. I submit that an arbitrary breach of an international contract is one in which the government brings into play its sovereign power to impose conditions upon the contractual relationship which obviously were not anticipated when the contract was entered into.*

Wadmond's submission is that a breach of contract which is not dictated by impossibility of performance, non-performance on part of the alien or the right reserved in the contract constitutes an arbitrary act. A similar view was held in the International Fisheries Case.[142] The American Government contention that the cancellation of the agreement was unlawful was rejected by the General Claims Commission.[143] The ground for such rejection was that the agreement expressly gave such power to the Mexican Government in case the Company fails to perform any of its obligations. The Commission, which found that the Company couldn't carry out one of its obligations, held that the cancellation was not an arbitrary act. The holding, accordingly, suggests that, had there not been a cancellation clause in the contract, there would have been a violation of a contract and which in itself might be considered as a violation of international law- arbitrary breach. In his Second Report on International Responsibility, F.V. Garcia – Amador tried to define arbitrary breach from the point of view other grounds of justified breach. He stated that a breach of contract which is not justified on the grounds of public interest or of the economic necessity of the state or which involves discrimination between nationals and aliens to the detriment of the latter is an arbitrary

---

[142] Ibid., pp 156-158. The Case arose because the Mexican Government cancelled a concession agreement with international Fisheries Company in which substantial part of the interest was owned by American national.

[143] The Commission was established by the two Governments to decide upon disputes of this type between them.

breach and is unlawful in international law.[144] In fact the statement holds true when a state action is not justified on other grounds either, such as impossibility of performance, non-performance on the part of alien and contractual permission.

3.4 Remedies of Unlawful Breach

It is a well-established principle of international law that any wrongful act committed against the property of the alien must be accompanied by reparation.[145] In the Chorzow Factory Case[146] it was stated that the measures of such reparation is restitution in kind or payment of pecuniary compensation of equal value.[147] The Permanent Court of International Justice to which the dispute was referred held that the purpose of reparation should be to restore an alien to its prior position, by restituting in kind or by paying equivalent money. A response by the Committee on the Nationalization of Property by the American Branch to the questionnaire of the International Committee on Nationalization also indicated that the measure of compensation which conditions a state's taking of alien interest not protected by treaty or contract is prompt, adequate(full) and effective compensation.[148] This statement seems to refer to lawful taking of alien property in international law.[149]

The rule relating to the remedies of taking of alien's property will have relevance to the problem of breach of concession agreements, for the breach of the contract may involve taking of the property, and many even equate contractual rights to property rights. In

[144] Wadmond, supra note 30, p. 165.
[145] Nwogugu, supra note 55, p. 191.
[146] In the Case Germany Contended that Poland expropriated industrial undertakings of Chorzow against the treaty between the two in 1922.
[147] Sornarajah, supra note 24, p. 141.
[148] Report of the International Committee on Nationalization, supra note 20, p. 33.
[149] I will not deal with these principles of compensation, because the concern here is not about the taking of alien's property (lawfully or unlawfully). They may be considered incidentally if they are found to be relevant to unlawful breach of concessions.

case of unlawful breach of the agreement the appropriate remedy, it is stated, is to order specific performance of the agreement.[150] Some, however, argue that pecuniary compensation is the better mode of reparation because it is impractical to have the agreement enforced in the territory of a state which breached the same.[151]

Reparation in the form of pecuniary compensation, if it is resorted to, for unlawful breach should aim at putting the injured party in the same position as he would have been if the wrongful act was not committed.[152] This involves claiming future profits or pecuniary benefits which the injured party could have received had the agreement not been breached.[153] On the other hand, it is stated that payment of fair compensation, which normally is the rule in case of lawful breach, is sufficient to remedy unlawful breach.[154] The view of equating lawful bleach with unlawful breach does not, however, seem sound. If concession agreements are binding in international law, then their unlawful breach, it is rightly said, should be accompanied with a punitive measure[155]; Otherwise characterization of these agreements as binding in international law will have no effect. The Court in the Chorzow Factory Case, thus, said that failure to make distinction between lawful and unlawful breach would "be tantamount to rendering lawful liquidation and unlawful dispossession indistinguishable in so far as their financial results are concerned."[156] Lord McNair also states that the lawfulness of the measure does have an important influence on the nature and extent of the compensation.[157] Now

---

[150] Report of International Committee on Nationalization, supra note 20, p. 47.
[151] Sornarajah, supra note 24, p. 142.
[152] Nwogugu, supra note 55, p. 191.
[153] Ibid., p. 192.
[154] Jennings, supra note 80, p. 173.
[155] Report of International Committee in Nationalization, supra note 20, p. 47.
[156] Jennings, supra note 80, p. 172.
[157] Henri Rolin, "Avis Sur la validite des Measures de Nationalization Decrettes par le Government Indonesian" (a Summary in English), Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964) p. 630.

I shall consider the two modes of reparation of unlawful breach of concession agreements, i.e., specific performance and pecuniary compensation.

3.4.1 Specific Performance or Restitution

Specific performance of an agreement requires a party that breached the contractual arrangement to carry out its promises as stipulated in the agreement. When the act of breach of a contract involves taking of the property, restitution of this property has been taken as appropriate remedy.

In its judgment in the Chorzow Factory Case in 1928, the Permanent Court of International Justice expressed the view that specific performance or restitution in kind was the proper form of reparation for an illegal taking of property.[158] It further stated that only when restitution in kind is not possible that damages should be awarded equivalent to the value of the property.[159] The idea is that first resort shall be had to restoration of the property taken. If this cannot be done for whatever reason, payment of damages shall be ordered. Wadmond argues for applicability of this rule of contract situation, that "money damages are not adequate compensation and that, to prevent irreparable injury, specific performance of the contract must be ordered."[160] The Committee on Nationalization of Property held that where restoration and performance of the concession contract is impossible, the concessionaire is entitled to pecuniary compensation.[161] Thus, the remedy for breach by a state of a contract with an alien is in the nature of specific performance.

---

[158] Richard Young, "Remedies of Private Claimants Against Foreign States", Selected Readings on Protection by Law of Private Foreign Investments, Texas, Mathew Bender and Company (1964), p. 937

[159] Ibid.

[160] Wadmond, supra note 30, p.149.

[161] Report of International Committee on Nationalization, supra note 20, p. 47.

This rule of remedies has good theoretical validity. If a defaulting party will be forced to perform its obligation or to restore the property it took through breach of the contract, it is prevented of benefit from its wrong. This, apart from entitling the injured party to its contractual right in a particular case, discourages the potential acts of breach. The rule is a logical consequence of the binding effect of concession agreements in international law.

However, practical problems are involved in its application. The Chorzow Factory Case remains to be the only case in which the principle is clearly referred to. And applicability of the principle to contractual situation is challenged on the ground that the Chorzow Factory case related to the taking of property in violation of treaty,[162] and not concession agreement. Sornarajah cites some arbitration instances in which restitution was not regarded as appropriate remedy despite the finding of illegality in breach of concession agreements.[163] Sornarajah maintains that in many instances of arbitration in which restitution and damages were practical remedies, arbitrators have chosen damages.[164]

This shows that as a practical matter tribunals have inclined to grant pecuniary damages much more frequently than restitution. That the tribunals have been reluctant to order acts of specific performance by a state. The principle thus enunciated has not been extensively followed in practice. This may be because of relative simplicity and convenience of pecuniary damages. Richard Young states that pecuniary awards have been construed as more acceptable to the delinquent state and, hence, more likely to

[162] Sornarajah, supra note 24, p. 142.
[163] Ibid., p. 143
[164] Ibid., p. 142.

be honored than specific performance or restitution.[165] In fact, it is unlikely that a state which has decided to terminate the agreement would permit the alien to return and resume operations. Michael D. Ramsely submits that because of the difficulty of enforcing specific performance against a foreign government, this claim is unlikely to be directly pursued in the context of concession agreements.[166]

3.4.2 Pecuniary Compensation

Where restitution in kind or specific performance is made there are no major difficulties. But the extent of pecuniary damages which could be a substitute for restitution or specific performance is difficult to define. Insofar as the rationale of all reparation is to restore the *status quo ante*, the assessment of the reparation must take the contractual situation into account. If pecuniary compensation is to restore the injured party to the position he would have occupied but for the abrogation of his contract, then such compensation must cover the entire loss suffered including prospective profits. Thus, it is said: [167]

> *The damage caused to one party by the illegal breaking of the contract comprises, as a rule, all the expenditure which it has made uselessly in carrying out its contractual obligations (damnum emergens), on the one hand, and, on the other hand, all the profits which the regular performance of the contract would have brought it (lucrum cessans).*

The point is that pecuniary compensation has two aspects: the property loss and loss of future interest. The breach of a concession agreement by a state results in substantial loss of property rights to the other party. The principal head of claim is for the value of

---

[165] Young, supra note 158, p. 936.
[166] Ramsey, supra note 32, p. 50.
[167] Whiteman, Damages in International Law (Vol. III, 1943), quoted in Nwogugu, supra note 55, PR 191-92.

actual property lost as a result of the breach. The principle of assessment of consequences of unlawful breach of concession agreements is taken as to have been well stated in award of Chorzow Factory Case. The Court stated that the reparation for an illegal act[168]

> *must as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in probability, have existed if the act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear.*

Where performance actually is no longer possible, then the foreign contractor must be placed as nearly as possible in the position he would have enjoyed absent the breach. That is to say, he is entitled to the profits he could have received had the contract not been breached. These are profits to be anticipated if the concession were allowed to run to its normal date of expiry. In the May Case between the United States and Guatemala involving a claim based on the taking over of a railway concession by the Guatemala Government, the arbitrator awarded compensation for losses, including lost profits. In so doing, the arbitrator stated that the alien, whose concession was withdrawn before expiry of contractual period, was entitled to the profit to be derived from the rail road until the completion of the term.[169] In the Delagoa Bay case (Delagoa Bay and East African Railway Company (U.S.) V. Portugal) the arbitrator was to decide on the amount of compensation against termination by Portugal of a railway concession. The arbitration held that reparations should be made for damage sustained and profit lost.[170] Thus, one can see that if a contract between a state and a private investor is terminated before it is due to expire, there is a strong case in favour of a

---

[168] The Chorzow Factory Case (1928), quoted in Report of International Committee on Nationalization, supra note 20, p. 34.
[169] Jennings, supra note 80, p. 173.
[170] Carlston, supra note 40, p. 261.

claim for future profits. This is well established in practice and is in line with the principle of respect for concession agreements

Determination of future profits, however, involves difficulty. Future profits are regarded by some as remote, speculative, and incapable of ascertainment.[171] As such it is suggested that *lucrum cessans* must be the direct fruit of the contract and not be too remote or speculative.[172] This requires that every claim for future profits must be supported by proof that the loss arose out of breach of the contract which could produce profits in the future. When a clear wrong is committed against such a substantial source of profit then a good case for a claim will arise. It was stated;[173]

> *There must be a manifest wrong, the effect of which prevents the direct and habitual lawful pursuit of gain, or the fairly certain profit of the injured person, or the profit of an enterprise judiciously planned accordingly to custom and business.*

Some two elements are clear from these statements to determine remoteness of future profits. First, there must be a close connection between the cause and effect. The loss must have resulted from the wrongful act of breach and not from any other extraneous cause. Second, such profit should be within the reasonable expectation of the contracting parties. It is said that international tribunals have been in the habit of awarding damages for prospective profits where the circumstances so justify. [174]

---

[171] Nwogugu, supra note 55, p. 192.
[172] Decision of the Arbitrator, supra note 54, p. 819.
[173] Nwogugu, supra note 55, p. 193.
[174] Ibid., p. 192

CHAPTER FOUR

THE ETHIOPIAN TREND

It is said that obstacles to investment must be removed if there is to be an increase in the amount of foreign capital investment in developing countries.[1] By investing his capital in a foreign country, an alien subjects it to local conditions. Accordingly, he is, no doubt, concerned with not only the existing situation with respect to foreign investment but also the situation that will probably exist in the future. To attract foreign investors capital-importing states should make adjustments to create lasting favorable investment climate. Some assurance as to the present and the future is needed. Fatouros holds that "the investor must be made to believe that there is little or no possibility that an unfavorable legal situation will be created at a later date." [2]

In a system where there has existed a favorable legal situation for long time or when the country's economic and political structure is so stable that there is little probability of any radical change in the immediate future, the investor gains such assurance as to the future. In most developing countries, which are under dynamic economic change, prediction of the future will not be possible. Thus arises the need for guarantees to be provided by capital-importing states to foreign investors. The guarantee constitutes the commitment that certain measures will not be taken or others will continue to be taken. This is an assurance that foreign investors will receive a definite legal treatment both today and in the future. A foreign investor who obtained such assurance will not fear that changes in local conditions will affect his interests.

---

[1] A.A. Fatouros, Government Guarantees to Foreign Investors, New York, Columbia University Press (1962), p. 62.
[2] Ibid., p. 63.

The guarantee to be granted may take the form of an undertaking not to take the property of an investor, a promise to lift a tax burden or general commitment not to make the obligation of the investor more onerous than that existed at the time of entering into the host state territory. State guarantees will have the effect of, Fatouros says, making the investor's loss less probable and promoting investments in developing countries.[3] The guarantees indicate that a favorable attitude toward a foreign investment prevails in the particular host state, and the state concerned is conscious of its own need for private investment and of the foreign investor's security.

Guarantees to foreign investors are issued by the host state. But an entity or a person to whom the guarantees are addressed is not always the same. It may be companies or private persons belonging to a state or several states, a company or a single private person. This depends on the form of guarantees, i.e., the type of the instrument by which guarantee is granted. Guarantees may be granted by international instruments and thus be founded on international law or they may originate in provisions of municipal law.

States may make the problem of foreign investment a subject of multilateral or bilateral treaty arrangements. Parties to the treaties undertake reciprocal obligations to grant guarantee in their territories to investors from state parties to the treaty. All investors from states parties to the treaties benefit form these arrangements. A more general promise of guarantee is to be found in municipal legislations. Any assurance in the investment legislation of a state is available for any foreign investor. Still another mode of investment guarantee relates to concession agreements. Only a particular investor who is a party to the concession agreement is beneficiary of this form of guarantee.

---

[3] Ibid., p. 64

Ethiopia has issued different programmes to achieve overall development. Among these is the economic policy which is meant to bring about progressive economic development. To attain this end Ethiopia, as any other developing state does, needs to attract foreign capital and skill. The country has issued investment laws, it has concluded treaties and concession agreements to assure foreign investors that there is a favorable investment climate. The task in this chapter is to identify the trend in Ethiopia as can be inferred from these modes of foreign investment guarantee. This is an attempt to see if the guarantees granted conform to the international standard or simply adopt nationalist view of the applicable law. We will try to find out whether the trend in this country is towards subjecting concession agreements to international law or municipal law.

4.1 National Laws

We have seen in the introductory statements of this Chapter that the manner in which guarantees are offered varies in several respects. The use of investment laws, i.e., statutes specifically designed to provide protection and encouragement to foreign investors, has become the common phenomenon. Such laws may have relative generality so as to address any field of investment or they may be so specific that they talk only about a sectoral issue. Guarantees may also be given in another way, as well: through constitutional instrument. This is done by incorporating special provisions in the law of general application.

The investment guarantee provisions as contained in these laws are indicators of a state's attitude towards foreign investment generally. And usually a state determines its promises in concession agreements on the basis of its laws. As such assessment of the

laws of a state relating to foreign investment is relevant, for from this assessment an inference as to the trend that has existed in relation to concession agreements can be made.

Having this purpose in mind we continue to consider the laws of Ethiopia. the examination of Ethiopia's municipal legislation, i.e., its constitution and its investment code, as they are the most common form of providing security for foreign capital within the state, will proceed. The emphasis is on their provisions having a bearing on the law applicable to relations between the Ethiopian government and a foreign investors.

A closer look at the history of the Ethiopian investment laws reveal that there existed no formalized legal methods as such designed to attract and facilitate foreign private investment into the country before the period of 1950's. As the Government became convinced that the traditional approach couldn't bring the needed foreign capital and skill, it began to formalize its idea. Accordingly, the country embarked upon the task of working out methods to facilitate foreign private capital investment in Ethiopia. It is in 1950 that the Government for the first time formalized its attitude and officially announced its investment policy.[4]

The first policy statement to encourage foreign investment was Notice No. 10 of 1950.[5] The second piece of legislation which supplemented the Notice was the Agricultural and Industrial Expansion Proclamation No. 145 of 1956.[6] To enhance its development plan

---

[4] Getahun Damte, Investment Decree No. 51 of 1963 (Unpublished, H.S.I.U, Faculty of Law, 1966), p. 29.
[5] Notice for the Encouragement of Foreign Capital Investment, Notice No. 10 of 1950, Negarit Gazetta, 9th year, No. 6
[6] Agricultural and Industrial Expansion Proclamation, Proclamation, No. 145 of 1954, Negarit Gazetta, 14th year, No. 3.

the Imperial Government issued the Investment Decree No. 51 of 1963,[7] which was later on replaced by a proclamation to provide for capital investment in Ethiopia (Proclamation No. 242 of 1966). The Proclamation was meant to amend some provisions of the Decree.

These laws were meant to create a favorable condition within the Country for foreign investors. Some of these accorded special facilities and benefits in the form of exemptions from tax, provided duty free importation of necessary machinery, others even went to the extent of allowing ownership over immovable properties. But none of these laws were comprehensive in regulating the relationship between the government and foreign investors. A proclamation issued to regulate investment in mining sector, Mining Proclamation No. 282 of 1971, is relatively more comprehensive and tends to show the trend that existed then. As examination of this law would enable one to observe whether there exists a shift in trend, we will continue to briefly consider some provisions of the Proclamation relating to our point of discussion.

The Proclamation gives a wider right to the Government to revoke the mining rights of a foreigner lessee. Art. 27 (a) of the Proclamation reserves the Government power to revoke a mining right where there has been a breach of any of the provisions of the Mining Proclamation or breach of any of the conditions contained in any mining right. The provision further states that the revocation takes place where a specified period, fixed by the Minster (of Ministry of Mines) requiring the lessee to remedy the breach, expires without the remedy being made. Here the point is that failure on the part of the investors to satisfy a condition or a requirement gives a right to the Government to

[7] Investment Decree, Decree No. 51 of 1963, Negarit Gazetta, 23rd Year, No. 1.

revoke the whole right of the investor. As such the law seems to give more power to the Government. The more the power a government reserves in its investment law, the more the tendency the foreign investment will be subjected to municipal legal system.

In fact, the Proclamation tells us that the mining investment is subject to the national laws of Ethiopia. Art. 8 reads:

> *A mining right shall be subject to the laws of the Empire of Ethiopia, provided that the provisions of administrative contracts within the meaning of the Civil Code of 1960 may apply only to the extent they are not inconsistent with the provisions of the present proclamation unless otherwise agreed by the Minster and the holder or lessee there of.*

According to this article a mining right which derives from the mining lease or concession shall be subject to the laws of Ethiopia. These are the laws applicable to all contracts in general and administrative contracts in particular. This is so only insofar as there is no inconsistency with the Proclamation under consideration. As per this proclamation the Ethiopian law applicable to the mining concession is a combination of the above categories of internal laws.

In fact, according to the same Proclamation, parties could dispense with the internal rules and make their own laws by agreements. So long as there is no limitation on the freedom of the parties with respect to the legal regime to be agreed upon, they may subject their relations to international law rules. Therefore, the subjection of mining rights to the municipal law is not absolute under the Proclamation.

The arbitration provision of the Proclamation (Art. 42) is also more or less in conformity with the above quoted article. It refers to the arbitration of disputes to the Convention on

the Settlement of Investment Disputes between States and Nationals of Other States (1965). Art. 42 of the Convention reads:

> *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 agreements, the tribunal shall apply the law of the contracting state party to the dispute and such rules of international law as may be applicable.*

The Convention gives freedom to the parties to the dispute to choose the law applicable to their dispute. In case of default to reach at an agreement, municipal law of the contracting state and rules of international law shall be applied in combination. The problem arises when there is inconsistency between the relevant rules of the two legal systems.

In the February 1974 Revolution, the monarchy that ruled Ethiopia for years was overthrown and socialism was declared as the political philosophy of the country. As a result the overall structure of the country's economic basis was changed. In line with the new economic policy the attitude towards investment was also changed.

Proclamations with a far reaching effect on the investment climate of the country were promulgated. Among these, that pertaining to the nationalization of the basic means of production had the prominent place.[8] According to this Proclamation the Government nationalized a number of domestic and foreign enterprises. For this reason the investment climate during this period remained depressing.

---

[8] Government Ownership and Control of Means of Production Proclamation, Proclamation No. 26 of 1975, Negarit Gazetta, 34th year, No. 22.

In the late 1980's the Government issued some proclamations and regulations as a response to the need for law dealing with joint investment and containing provisions that would encourage foreign investment. The most relevant of these is the Petroleum Operations Proclamation No. 295 of 1986.[9] Article 26 of the Proclamation states that "all petroleum agreements and petroleum operations shall be governed by the laws of Ethiopia." The statement seems to leave no room for the possibility of agreement by the parties on any other applicable law. Whether a municipal law as existing at the time of the agreement or as it exists from time to time would apply is not clear. The legislator seems to have intended to freeze the applicable municipal law as it existed at the time of making of the concession agreement as the Proclamation provides that "any petroleum agreement shall provide... for the stabilization of the rights and obligations of the parties."[10]

The arbitration provision (art. 25) declares the possibility of dispute resolution through negotiations or arbitrators as it states:

> *Any dispute, controversy or claim between the Government and the contractor arising out of or relating to, the petroleum agreement or the interpretation, breach or termination there of shall, to the extent possible, be resolved through negotiations. In the event the agreement can not be reached through negotiations, the case shall be settled by arbitration in accordance with the procedures specified in the petroleum agreement.*

Settlement of disputes through negotiations is given priority to arbitration. The dispute shall be referred to arbitration only when negotiation fails. The substantive law to be applied by the arbitrator is not, however, indicated. It may, therefore, be said that the arbitrator is to apply the law mentioned in the "applicable law" provision (Art. 26), i.e.,

---

[9] Petroleum Operations Proclamation No. 295/1986, Negarit Gazetta, 45th year, No. 6
[10] Ibid., Art. 9 (10)

the laws of Ethiopia. On the other hand, the "without prejudice to Article 25 of this proclamation" phrase in the applicable law provision (Art. 26) seems to imply that the arbitrator may apply any other law than the laws of Ethiopia.

With the coming into power of EPRDF a new economic policy was adopted to promote participation of private capital. It is, therefore, necessary to have the law which implements the economic policy and that facilitates and encourages private sector's participation in the economy.

Some try to find guarantees of foreign investment in FDRE Constitution itself. True, the constitutions of most states contain provisions dealing with the security of private property. Such constitutional provisions may apply to nationals and non-nationals alike.[11]

Art. 40 (2) of the FDRE Constitution gives the definition of private property:

> *Private property.... Shall mean any tangible or intangible product which has value and is produced by labour, creativity, enterprise or capital of an individual citizen, associations which enjoy juridical personality under the law, or in appropriate circumstances, by communities specifically empowered by law to own property in common.*

Apart from defining private property, the provision also defines persons that may own property. An individual citizen, associations enjoying personality under the law or communities authorized by law may own property as per this Article. Under the third category foreigners may have the chance to own property as communities.

---

[11] E.I. Nwogugu, "Legal Problems of Foreign Investments", Academic De Droit International, (vol. 5, 1976) p. 190.

The argument is that if foreigners' investments are considered to be private properties owned by foreigners, then they are protected under Art. 40(8) which provides: "Government has the power to expropriate, in the public interest private property. In all such cases, government shall pay compensation in advance commensurate to the value of the expropriated property." This provision means that the Government cannot take the private property, including foreign investment, unless for public interest reason and upon payment of compensation in advance. This constitutes a constitutional guarantee of foreign investment.

The most relevant legislations in force in Ethiopia today with regards to concession agreements are the Investment Proclamation (Proclamation No. 280/2002), the Mining Proclamation (Proclamation No. 52/1993) and Petroleum Operations Proclamation (proclamation No. 295/1986). Petroleum operations proclamation has already been dealt with in the foregoing paragraphs, and we need not consider it again.

It is common that investment laws of many states guarantee foreign investment against expropriation. The guarantee in this respect does not constitute absolute preclusion from taking the property; expropriation is carried out subject to compensation. The Investment Proclamation (proclamation No. 280/2002) in Article 21 provides:

> *No investment may be expropriated or nationalized except when required by the public interest and then, only in compliance with the requirements of the law. Adequate compensation, corresponding to the prevailing market value, shall be paid in advance in case of expropriation or nationalization of an investment for public interest.*

To take any property belonging to an investor either by way of expropriation or nationalization, the investment law, which is applicable both to domestic and foreign

investors, requires the fulfillment of some conditions. First, there must be public interest justifying such taking. Second, the action should be in accordance with the law. This is a statement that requirements in any other category of municipal law, if any, with respect to expropriations or nationalization should be observed. Thirdly, adequate compensation is to be paid in advance.

Under the FDRE Constitution the amount of compensation to be paid in case of taking should be commensurate to the value of the property taken (Art. 40(8)), whereas the Proclamation requires that the compensation be "adequate". What is "adequate" may be less than the value of the property. As such the two municipal laws are setting different standards of guarantee.

Occasionally dispute may arise between the host state and the foreign investor with respect to their rights and obligations as provided in the law. In order to preserve their relations, it is important to have a dispute settlement mechanism. Investment dispute settlement mechanism is one mode of investment guarantee. As such the comprehensive investment laws do not fail to contain the dispute settlement provision.

The previous investment proclamation (Proclamation No. 37/1996), which has been repealed by the present investment law, stated in Art. 22 that "a dispute not amicably settled may be submitted o the competent court of the country or international arbitration." Here disputes between the Government and holders of investment rights might be settled through negotiation and agreement. In the event the disputes could not be resolved by mutual agreement, there exists another method – international arbitration.

However, the current proclamation completely removed the provision on the settlement of investment disputes. This adds one factor to the insecurity of foreign investors. The consequence may not be as such harsh, for the parties may make the problem the subject of their agreement.

The Mining Proclamation No. 52/1993 relates specifically to prospecting, exploration and exploitation of mineral resources. It is more comprehensive than that of the Investment Proclamation in that it has provisions on the dispute settlement mechanism. Art. 51 (5-6) requires that only dispute between the Government and the licensee as to the interpretation, breach or termination shall be resolved through negotiations. The case is to be submitted to arbitration if agreement cannot be reached through negotiation.

The position in the Proclamation seems more of subjecting the concession agreements to the municipal law. It does not seem to allow parties to agree against the rules of the Proclamation. Art. 54 (1) implies this view:

> *All mining rights existing before entry into force of this proclamation shall remain valid and shall be governed by the terms of that agreement provided, however, that if such terms are inconsistent with the provisions of this Proclamation, the Licensing Authority shall undertake negotiations with the holder of such right so that the terms of such right shall, in so far as practicable, be revised to conform to the provisions of the this proclamation.*

The idea in the provision is that concession agreements which are concluded before coming into force of the Proclamation and which are inconsistent with it need to be revised. Equally implied is the intention of the legislator that subsequent agreements be made in conformity with this law, that the proclamation, forming part of the municipal law, is the governing law.

4.2 Treaties

One of the most common and widely used method for protection of investment is by conclusion of international agreements. Treaties may be multilateral or bilateral in nature. Involvement of states in bilateral and multilateral treaties with respect to investment makes the investment by a national of a state in the territory of another state more secured. These measures are more important to developing countries in order to get the confidence of foreign investors.

Multilateral conventions may be preferred to bilateral treaties in that they provide guarantee in the single instrument for investors from several states. On the other hand, bilateral arrangements for protection of foreign investment are restricted in the sense that they govern the relationship between only two states. Multilateral investment conventions under consideration set a standard of relationship between a state and the nationals of other states.

One of such multilateral conventions is the one establishing the Multilateral Investment Guarantee Agency (MIGA). MIGA was established on April 12, 1988 as an agency of the World Bank with the purpose of promoting foreign investment in developing countries.[12] It provides insurance coverage guarantee arrangements against non-commercial or political risks, which may face the foreign investor[13]. MIGA offers political risk insurance to foreign investors in developing countries. One of the guarantees offered by MIGA relates to losses arising from the host state's breach of a concession agreement with the investor.[14] When compensation is due to the investor and such

[12] World Bank, Annual Report (1997), p. xi.
[13] World Bank, Annual Report (1993), p. 103.
[14] MIGA, Investment Guarantee Guide, The Multilateral Investment Guarantee Agency: a Member of the World Bank Group, (1996), pp. 5-8.

payment is not effected within a specified time, MIGA effects the payment and is subrogated into the rights of the foreign investor.[15]

Ethiopia ratified the Convention of MIGA in 1990.[16] Thus, the guarantee scheme of MIGA applies to foreign investors from member states who invest in Ethiopia. The significance of membership of Ethiopia to the MIGA is that the country recognizes that concession agreements concluded with a national of another member state is subject to international law.

Similarly, the country had signed on September 21, 1996 the International Center for Settlement of Investment Disputes (ICSID) Convention which aims at the settlement of investment disputes between a member state and national of another member state.

The Center, which derives Jurisdiction from the consent of the parties,[17] facilitates arbitration and conciliation on disputes arising from foreign investments.[18] As to the law to be applied by the Center the Convention (Art. 42 (1)) states:

> *The tribunal shall decide dispute in accordance with such rules of law as may be agreed y the parties. In the absence of such agreements, 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.*

The disputing parties may agree upon the law that shall be applied by a tribunal. When they fail to reach at such agreement, the tribunal is to apply municipal law of the host state and rules of international law. The rules from the two systems are to be applied in

---

[15] Ibid.
[16] The Council of State Decree No. 39/1990, the Decree to Ratify the MIGA Convention, Nagarit Gazetta, 50th year, no. 1.
[17] G. R. Delaume, "Convention on the Settlement of Investment Disputes between States and Nationals of other States," International Lawyer, Vol. I, (1966), p. 65.
[18] World Bank, Annual Report, (1997), p. x.

harmony; municipal rules should be applied by the international tribunal in conformity with the applicable rule in international law.

As such the membership to the Center implies acceptance on the part of the member state to accord more and more protection to foreign investment, which also includes agreement based investment-i.e., internationalization of concession agreements

The existence of bilateral treaties between states for the purpose of reciprocal protection of foreign investments also implies the same trend. Most capital exporting states have concluded bilateral treaties with developing countries for the purpose of protecting investment of their nationals. Recognizing this purpose developing states have also been parties to such arrangements.

Ethiopia has concluded at different times many bilateral commercial treaties with capital exporting states in each of which reciprocal obligation is assumed to protect a foreign investment by the national of another party. The Ethiopian Investment Authority is empowered by the Investment proclamation to negotiate bilateral investment promotion and protection treaties for conclusion between Ethiopia and other countries and to sign the same upon approval by the Council of Ministers (Proclamation No. 280/2002, Art. 30(10)). Since the coming into effect of the new economic policy Ethiopia has become a party to seventeen bilateral treaties (Interview with legal department officer in Ethiopian Investment Commission). Some of the protective measures in these treaties relate to non-discrimination, property protection and settlement of disputes.

The preamble to the bilateral agreement between the Federal Democratic Republic of Ethiopia Government and the Swiss Confederation on promotion and reciprocal

protection of investments (1998) states recognition of the need for protection of foreign investment. Art. 4(1) of the Agreement requires that foreign investments be accorded fair and equitable treatment, and that no contracting party shall impair by unreasonable or discriminatory measures such investments. These are requirements which are to prevail over national standards.

Agreement was also reached that a contracting state party should not take the property of a foreign investor, unless the taking is in the public interest and on non-discriminatory basis upon payment of effective and adequate compensation (Art.6). This in a way is setting a standard beyond the reach of the host state to protect foreign investment.

The dispute settlement clause in the Agreement implies the acceptance on the part of the parties as to internationalization of the dispute. This is so because the clause provides for resolution of disputes through international arbitration. A dispute between a contracting state and the investor of the other contracting state may be resolved amicably. And when negotiation fails, the investor may submit the dispute, at his choice, for settlement to:[19]

a) the competent domestic court of the host state, or
b) the International Center for Settlement of Investment Disputes established by the Convention on Settlement of Investment Disputes between states and nationals of other states, or
c) an *ad hoc* arbitral tribunal

[19] Agreement Between the Government of Swiss Confederation and FDRE Government on Promotion and Reciprocal Protection of Investments (1998), Art. 8 (1-2).

All other commercial bilateral treaties which the Ethiopian Government concluded with other states, and which I had chance to look at, such as the Republic of Tunisia,[20] the Republic of the Sudan,[21] and the Republic of Yemen,[22] provide alike with respect to the areas of guarantee we considered hereinabove in the Agreement with the Swiss Government. In these treaties agreement is reached to fairly and equitably treat foreign investment, not to impair investment by unreasonable or discriminatory measures, and to refer the dispute to international arbitration when negotiations fail.

It is good to note here that the terms of all these agreements do not make distinction between investments in the form of concession agreements and other wise. In each of the treaties "investment" is defined to include business concessions conferred by law or under contract, such as concessions to search for, extract, exploit or develop natural resources.[23]

The conclusion of bilateral treaties such as those referred to above implies that Ethiopia has recognized the possibility of international law governing foreign investments, be it in the form of concession agreements or otherwise.

4.3 Concession Agreements

A third form of state guarantee to foreign investment relates to the promise given in concession agreements. It is said that the meaningful study of the legal effects of state

---

[20] Agreement between FDRE Government and the Government of the Republic of Tunisia for Reciprocal Promotion and Protection of Investments, December 14, 2000.
[21] Agreement between FDRE Government and the Government of the Republic of the Sudan for Reciprocal Promotion and Protection of Investments, March 7, 2000.
[22] Agreement between FDRE Government and the Government of the Republic of Yemen for Reciprocal Promotion and Protection of Investments, April 15, 1999.
[23] For example, Agreement with Tunisia (Art. 1 (a(v))); Agreement with Swiss Government (Art. 2 (e))

guarantees to foreign investors can only be made in relation to the contractual commitments undertaken by states toward the nationals of other states.[24] The view is that the promise of a state in concession agreements is the most reliable one, as this is the specific commitment to be undertaken by a state against a particular foreigner.

Through a concession agreement the state grants to an alien individual or foreign company certain powers and rights which would other wise belong to itself only. It includes contracts granting to individuals or corporations the right to operate certain enterprises, which are monopolistic by nature or as a result of legal regulation.[25] The term also includes economic concessions, namely, contracts giving to private persons the right to exploit the natural resources of a country.[26] Similar in character are the contracts of public works, through which public authority charges a private person with the construction of roads or bridges, against payment for their services.

Most of the foreign investments are subject to special contractual arrangements between the investor and the host state.[27] This is initiated by foreign investors with the view to obtain favorable binding terms.

Ethiopia has concluded several concession agreements with foreigners in different areas of investment. Many of these agreements relate to exploitation of natural resources of the country and construction of roads and bridges. These agreements contain clauses which have a bearing on the status of the agreements, i.e., the standard of guarantee granted by the host state. In the following paragraphs, we will

---

[24] Fatouros, Supra note 1, p. 232
[25] Ibid., p. 233.
[26] Ibid.
[27] M. Sornarajah, The Pursuit of Nationalized Property, Dordrecht, Martinus Nijhoff Publishers (1986), p. 125.

examine some clauses in different concession agreements as implying the trend in this country as to the standard of guarantee granted to foreign investment.

In the Agreement between the Empire of Ethiopia and the Gulf Oil Company, the latter was irrevocably granted the right to perform all acts necessary to determine the existence of petroleum in the development area and to produce, extract and sell it.[28] This basic grant provision states the strong commitment of the State to be bound by the Agreement as it "irrevocably" grants those rights to the Company. But in another Article the Government reserves the right "to take all measures necessary to maintain the internal security and territorial integrity of the Empire of Ethiopia."[29] It may also exercise other powers the exercise of which will not unreasonably interfere with the rights granted to the Company.[30] As per these provisions the Government may, by way of maintaining internal security and territorial integrity or reasonably exercising other powers, interfere with or revoke the terms of the Agreement. Thus, the commitment not to revoke the terms of the agreement is qualified.

On the other hand, the Government undertakes that the rights of the parties "shall not be enlarged, reduced or otherwise modified by any existing or future law." (Art. xxvII(3b). This is the promise that the Agreement would not be affected by existing or subsequent legislation. The provision both establishes the supremacy of the Agreement to the existing law and stabilizes the law as existing at time of making of the contract. It seems that the context requires this promise to be subject to the power of the Government as stated in the preceding paragraph.

---

[28] Petroleum Development Agreement by and between the Empire of Ethiopia and Gulf Oil Company of Ethiopia, November 1963, Art. I (a-b).
[29] Ibid., Art. xxvii (1).
[30] Ibid., Art. xxvii (2)

The Agreement also excuses both parties from carrying out their respective obligations in the event of *force majeure*, which includes fire, flood, epidemic, war, etc, (Art.xxxvi). All these show that the Government recognized the Agreement as binding, and that it may lawfully be breached under exceptional circumstances.

As to the applicable law the Agreement (Art.xxvIII) states to the effect that rules of international law are applicable. The provision reads:

> *Wherever in this Agreement specific provision is made for the application of Ethiopian law, such law shall govern, otherwise, this Agreement shall in all respects be governed by and interpreted in accordance with generally recognized principles of international law.*

This Article establishes the order of priority between the domestic law and general principles of law as applicable to the Agreement. If there is specific reference to the municipal law, this law applies. In the absence of such stipulation resort shall be had to general principles of international law. Nowhere in the Agreement is reference made to the Ethiopian law. Thus only general principles of international law remain applicable. Moreover, the parties expressly declared that the Agreement would not constitute an administrative contract as the term is used in the Civil Code of Ethiopia (Art. xxx II). As such the parties waived the application of provisions governing administrative contracts. This is a recognition that the Agreement is different from municipal administrative contracts.

Article xix of the Agreement talks about the dispute settlement mechanism. When the dispute between the parties arises in relation to execution, interpretation or breach of the Agreement, it shall, unless resolved by written agreement, be submitted to arbitration. The arbitrator is required to give effect to the declared intention of the

parties, and to rely upon generally recognized principles of international law when the need to resort to substantive law arises. All these clauses we have considered so far indicate that the Agreement is considered as existing in international law.

The Agreement between the Ethiopian Government and Ethiopian Potash Company[31] provides on the problems of arbitration and applicable law almost in the same manner as in the Agreement we have so far considered. The "governing law" clause (Art. xxv) declares that the laws of the Empire of Ethiopia shall govern the Agreement; provided, however, that any existing or future law cannot affect the contractual terms. As such the contract is superior to the law. The Government renounces its power to make any law that will affect contractual rights. The domestic law would be applied only to fill the gaps in the agreement.

The dispute between the parties shall, in the absence of solution by agreement, be determined by arbitration (Art. xix). The arbitrators are to apply Ethiopian law; provided, however, that if the issue in the dispute relates to breach or termination of the contract, principles of law which are generally recognized in both the Empire of Ethiopia and in the United States of America shall be applied. If there are no such principles of law, the arbitral tribunal shall apply principles generally recognized in international law. Thus, we see that both legal systems, municipal law and international law, govern the agreement.

The Imperial Ethiopian Government has also concluded concession agreement with the British Canadian Mining Corporation.[32] The Concession was made subject to the laws

---

[31] Contract of Concession between the Imperial Ethiopian Government and Ethiopian Potash Company, November 4, 1968.

[32] The Concession Agreement between the Imperial Ethiopian Government and the British – Canadian Mining Corporation, July 30, 1969.

of Empire of Ethiopia, "provided that the provisions of the administrative contracts within the meaning of the Civil Code of 1960 may apply only to the extent not inconsistent with the provisions of the concession." (Art. xxv). In arriving at any decision the arbitrators are required to apply these rules of law (Art. xix). This in away is a departure form the already considered two agreements in which rules of international law are mainly applicable and application of rules relating to administrative contracts is excluded. We see that in the Imperial era as one goes from the early 1960's to the late 1960's the trend shifted from internationalization of concession agreements to nationalization.

The Agreement with B. P. Petroleum Development Ltd. relates to exploration and exploitation of petroleum.[33] Section xvi of the Agreement provides for the applicable law and the dispute settlement mechanism. The Agreement was to be governed by, interpreted and construed in accordance with the laws of Ethiopia. In the event the subsequently issued law substantially affects the interest of a party in the Agreement, parties are required to agree to make the necessary adjustments to the provisions of the Agreement to restore the affected party to a condition that could have existed if modification of the law had not taken place. When a dispute between the parties cannot be mutually resolved by the parties, it shall be submitted to international arbitration.

These statements make it clear that the municipal law exclusively governs the Agreement. As the Agreement is to be interpreted and construed in accordance with the municipal law, the international arbitration tribunal, it may be said, is to apply the Ethiopian law.

---

[33] Production Sharing Agreement for the Exploration and Production of Petroleum between the Government of Peoples Democratic Republic of Ethiopia and B. P. Petroleum Development Limited (I couldn't cite the date of signature because I had access only to the draft agreement which was presented for signature)

Almost similar clauses as to the governing law and the dispute settlement mechanism are contained in the Agreement with Ethiopian Hunt Oil Company,[34] except that in this case the company seems to have obtained relatively more favorable terms in relation to the modification of the applicable law by subsequent legislation and the law to be applied in arbitration. In both agreements the municipal law as it exists from time to time is to govern the contractual relations between the parties. When the amendment or change of the law substantially affects the interest of a party, the parties, in the Agreement with B.P. Petroleum Development Ltd., are merely required to agree to make adjustments to restore the position of the affected party. The enforceability of this requirement is unlikely, because there is no remedy or sanction in case of refusal by a party to agree to make such adjustments. The Agreement with the Hunt Oil Company, however, requires the Government to indemnify the Company "in respect of any economic loss it suffered as a result of the promulgation of new laws" (section xvi). Even if the Ethiopian law is agreed upon to govern the Agreement with the Hunt Oil Company, arbitrators are required to apply "the generally accepted principles of international oil and gas law" in reaching at their decision (section xvi). In this respect the Agreement is subject to rules of international law. As such the municipal law and the relevant rules of international law are to be applied in harmony. In case of inconsistency, for arbitration purpose, the rules of international law shall be preferred as this is stated specifically in the Agreement.

Agreements concluded between the Government of Ethiopia and foreign companies in the area of road construction generally adopt the view of nationalization of concession

[34] Production Sharing Petroleum Agreement between the Government of the Peoples Democratic Republic of Ethiopia and Ethiopian Hunt Oil Company, 1990. This Agreement was amended twice without affecting the arbitration and the governing law clauses, and it lapsed in 1998.

agreements. The contract with Dragados-Zeus Joint Venture is one of these.[35] In a letter for notification of the contract award (by the Ethiopian Roads Authority) to the Joint Venture it was stated that until the time when the contract agreement prepared by the Authority would be signed by the Company, the notification letter together with the Company's tender should form a binding contract between them. This is a declaration as to the binding effect of the Agreement. But examination of the contract provisions and instruments that are incorporated in the Agreement reveals that only the Company is in effect bound by the Agreement. This is because the Authority has broader power to terminate and suspend the Agreement. In other words, enjoyment by the Company of its contractual rights is very much subject to the power of the Authority.

The General Conditions for Works of Contracts Financed by the European Development Fund, which as such makes part of the Agreement and from whose provisions no departure is made in the Agreement, contains many of these provisions giving unlimited power to the Government. The General Manager of the Authority is given power to vary any term of the contract (Art. 37). The Authority may also terminate the Contract at any time (Art. 64). The works of the Company are subject to suspension by the order of the General Manager of the Authority (Art. 38).

More importantly, Article 2(4) of the Agreement reads: "This contract is an administrative contract as defined in the Civil Code of 1960 of the State of the Contracting Authority." The Contract is considered as the public contract in municipal law. As such it is under the full control of the Government, and it may be varied or terminated at will of the Government. Sornarajah states that the special feature of

[35] The Addis Ababa – Modjo-Awasa Road Rehabilitation Project Works Contract between Ethiopian Roads Authority (on behalf of the Ethiopian Government) and Dragados – Zeus Joint Venture, August, 1997.

administrative contracts is that of the possibility of their variation or termination by the state.[36]

Another agreement in the field of road rehabilitation is one concluded with China National Water Resources and Hydropower Engineering Corporation (CWHEC)[37]. The Agreement relates to rehabilitation work of the Addis Ababa – Ginchi-Ambo road. This Agreement, too, has same features as those in the hereinabove considered agreement. The Government is given right in the Agreement to terminate the contract at any time for its own convenience (Art. 75 (1)). And the Ethiopian law is stated to be the governing law (Art. 5 (1)).

The national control of the parties' relationships has been the common feature of these concession agreements relating to road rehabilitation works. These agreements are, therefore, more of national than international in character.

The two model concession agreements, one relating to exploration of petroleum in general[38] and the other for petroleum exploration in Afar area[39] provide alike as to the applicable law. The governing law clause of each of the model agreements provides that "the agreement shall be governed by, interpreted and construed in accordance with the laws of Ethiopia" (Art. 16 (1)). These provisions state the recent position of the Government as to the status of concession agreements.

---

[36] Sornarajah, Supra note 27, p. 131.
[37] The Agreement between Ethiopian Roads Authority and China National Water Resources and Hydropower Engineering Corporation (CWHEC), August 15, 2002.
[38] Model Production Sharing Agreement for the Exploration and Production of Petroleum with the Government of Ethiopia, 1994.
[39] Production Sharing Agreement in an Area of North Eastern Ethiopia between the Government of Ethiopia and Afar Exploration-Company, LLC of Tulsa, Oklahoma, USA, February 2005.

The standard of guarantee accorded to concession agreements has not been consistent. In the early 1960's the trend was towards internationalization of concession agreements. It is natural that during the socialist regime the government enjoyed broader power of control over foreign investments in general and investments subject to concession agreements in particular. The present trend is also towards subjecting these agreements to the national law.

CONCLUSION

There is good reason to assert that contracts between corporations belonging to countries having skill and capital to spare and governments of countries needing these commodities for the development of their natural resources will continue to be made. It is important that the parties to such contracts should be in agreement as to the system of law which should govern them and within which they should operate. The agreement is expected to be as complete in its coverage of the rights and obligations of the parties as the negotiators can possibly make it. If the state desires the right to alter or abrogate the agreement prior to its expiration, it should endeavor to get such privilege expressed in the agreement at the time of negotiation. It is also advisable that the parties incorporate a law to which reference is to be made for the purpose of filling contractual gaps or interpreting provisions in the agreement.

Thus, a concession agreement is considered as an expression of the power possessed by states, by companies and by individuals to collaborate in energizing the economy and in creating a legal regime for the complete governance of their relationships with one another. The agreement can provide the means for solving every problem the parties encounter thereafter during the life of the agreement.

Practically, however, many agreements fail to be complete. In case of such silence, some argue, the parties shall be deemed to have an implied intention that municipal law of the host state be applied. That a concession agreement is concluded and is to be carried out in the territory of the host state and that there exists no international law rule as to the validity of such agreement are taken as the basis of this view.

To subject a concession agreement to a national law of a host state amounts to empowering the latter to modify or terminate the contract at will. To permit this change would result in the substitution of the will of the state for law. This deprives the world of one of the means for its betterment, because if agreements are to rest upon such an uncertain basis as arbitrary state power, concession agreements will not be made.

Other authorities, accordingly, submit that international law should be the governing law in this circumstance. There is a considerable body of authority for the view that the theory of internationalization of contracts should be accepted. The idea is that the objective which the concession agreements are meant to attain would be possible only when a relationship created by these agreements is certain. And certainty exists when the agreement is governed by international law, a law which is external to the parties and is beyond the control of a host state.

In view of this purpose international law recognizes the binding character of concession agreements. In fact, the proper environment for continuing benefits flowing from concession agreements lies in reliance upon the contract. That concession agreements are of great import makes it necessary to protect commitments in such agreements. Security of concession agreements is an important element of investment. States are bound to observe these agreements with citizens of other states just as they are bound to observe their treaties with other states.

The principles of *pacta sunt servanda* and acquired rights support the conclusion that agreements are binding on parties. The idea is that a consent given freely should be respected, and that rights which are acquired through an agreement cannot be

withdrawn. The very purpose for which parties enter into agreements explains why their agreements should be respected or rights acquired should not be revoked.

There are, however, circumstances in which the rule that concession agreements are binding is excepted. International law recognizes that a party may be excused of the breach of a contract in he existence of an event that enables so to do. Reservation of such a right in the contract and failure on the part of the other party to respect its promises are some of the exceptional situations under which an agreement may lawfully be breached.

Any other form of breach which is not justified on these grounds remains to be unlawful. Remedies for unlawful breach should be able to reinforce the binding character of concession agreements. International law requires the defaulting party to perform its obligation or to restore the property if the breach involves taking of the property. In case these remedies are not proper in the circumstances, payment of pecuniary compensation including future profits is to be ordered.

It is against these standards that the Ethiopian trend is seen. Ethiopia has been no exception to the international economic relations. There has been flow of foreign investment to the country. Many laws have been issued, treaties signed and concession agreements concluded to define the relationship between the Government and foreign investors. The trend has not been consistent. At one time reference had been clearly made to international norms. In recent instruments the tendency is more of subjecting the relations to Ethiopian municipal law.

Concession agreements give rise to rights and obligations of the parties involved. A party assumes an obligation and carries it out expecting that another party will do the same. So, security of performance of obligations is the essence of concession agreements. The possibility of performance, should not be left to the will of a party. To subject a concession agreement to municipal law of the host state is to subject its performance to the will of the state. The host state may revoke its obligation by subsequent municipal legislation. This will endanger the international economic relations emanating form concession agreements, and foreign companies or alien individuals may not be willing to enter into such agreements about the performance of which they are not certain.

Certainty of relations would be created by making agreements subject to a legal system which is beyond the reach of parties. This legal system, more conveniently, is international law. Adopting international law as applicable to concession agreements enables host states to attract more and more foreign investment. In fact, some foreign investors, who are attracted by the benefit they would receive, may assume the risk of non-performance and may become party to concession agreements which are subject to national law of the host state. But the trend of nationalization of concession agreements would not help the state to get foreign capital and skill in a required quantity. This suggestion has even more appeal to Ethiopia, the country which relies on foreign investment for its economic development and which has adopted new policies to attract foreign investment.

BIBLIOGRAPHY

Books

1. Amerasinghe, C. F., State Responsibility for Injuries to Aliens (Oxford, Oxford University Press, 1967).
2. Brierly, J. L., The Law of Nations (Oxford, Oxford University Press, 1963).
3. Fatouros, A.A., Government Guarantees to Foreign Investors (New York, Columbia University Press, 1962).
4. Foighel, Isi, Nationalization and Compensation (London, Stevens and Sons Ltd., 1964).
5. Friedman, S., Expropriation in International Law (Westport, Greenwood Press, 1981).
6. Hohenveldern, Ignaz Seidl, Collected Essays on International Investments and on International Organizations (London, Kluwer Law International, 1998).
7. Nwogugu, E. I., The Legal Problems of Foreign Investment in Developing Countries (Manchester University press, 1965).
8. O'Connell, D. P., The Law of State Succession (London, Cambridge University Press, 1966).
9. Snyder, Frederick E. and Sathirathai, Surakiart, Third World Attitudes toward International Law – An Introduction (Boston, Martinus Nijhoff Publishers, 1987).
10. Sornarajah, M., The Pursuit of Nationalized Property (Dordrecht, Martinus Nijhoff Publishers, 1986).
11. The South Western Legal Foundation, Selected Readings on Protection by Law of Private Foreign Investment (Texas, Mathew Bender and Company, 1964).

Periodicals

1. "Abu Dhabi Arbitration Award", International and Comparative Law Quarterly, Vol.1, (1952).
2. "Anglo-Iranian Oil Company Case", American Journal of International Law, Vol. 46, (1952).
3. Borchard, Edwin M., "The Law of Responsibility of States for Damage Done in their Territory to the Person or Property of Foreigners", American Journal of International Law, Vol. 23, (1929).
4. Bourquin, Maurice, "Arbitration and Economic Development Agreements", Business Lawyer, Vol. 15, (1960).
5. Briggs, Herbert W., "The Attorney General Invokes Rebus Sic Stantibus", American Journal of International Law, Vol. 36, (1942).
6. Carlston, Keneth S., "Concession Agreements and Nationalization", American Journal of International Law, Vol. 52, (1958).
7. "Decision of the Arbitrator in he Claim by the U.S.A. on Behalf of P. W. Shufeldt Against the Republic of Guatemala", American Journal of International Law, Vol. 24, (1930).
8. Delaume, G. R., "Convention on Settlement of Investment Disputes Between States and nations of Other States", International Lawyer, Vol. 1, (1966).
9. Delson, R., "Nationalization of Suez-Canal Company: Issues of Public and Private International Law", Columbia Law Review, Vol. 57, (1957).
10. Domke, Martin, "Foreign Nationalization: Some Aspects of Contemporary International Law", American Journal of International Law, Vol. 55, (1961).
11. Garner, T., "The Doctrine of Rebus Sic Stantibus and the Termination of Treaties", American Journal of International Law, Vol. 21, (1927).

12. Geiger, R., "The Unilateral Change of Economic Development Agreements", International and Comparative Law Quarterly, Vol. 23, (1974).

13. Greenwood, C., "State Contracts in International Law – The Libyan Oil Arbitrations", The British Year Book of International Law, Vol. LIII, (1983).

14. Hyde, James N., "Permanent Sovereignty Over Natural Wealth and Resources", American Journal of International Law, Vol. 50, (1956).

15. Jennings, R. Y., "State Contracts in International Law", The British Yearbook of International Law, Vol. xxxvii, (1961).

16. Lauterpacht, Hearsch, "The Problem of Jurisdictional Immunities of Foreign States", The British Year Book of International Law, Vol. xxxviii, (1962).

17. Mann, F.A., "State Contracts and State Responsibility", American Journal of International Law, Vol. 54, (1960).

18. Mann, F. A., "The Proper Law of Contracts Concluded by International persons", The British Year Book of International Law, vol. xxxv, (1959).

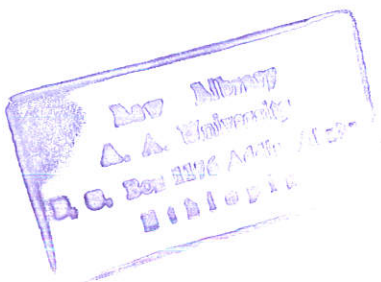
19. McNair, Q. C., "The General Principles of Law Recognized by Civilized Nations", The British year Book of International Law, Vol. xxxiii, (1957).

20. Mazzini, Danielle, "Stable International Contracts in Emerging Markets", Boston University International Law Journal, Vol. 15, (1997).

21. Nwogugu, E. I., "Legal Problems of Foreign Investments", Academic De Droit International, Vol. 5, (1976).

22. O'Connell, D. P., "A Critique of the Iranian Oil Litigation", International and Comparative Law Quarterly. Vol. 4, (1955).

23. Ramsey, Michael D., "Acts of State of Foreign Sovereign Obligations", Harvard International Law Journal, Vol. 39, (1998).



24. Rawding, Nigel, "Protecting Investments Under State Contracts: Some Legal and Ethical issues", Arbitration International, Vol. 11, (1995).
25. Waelde, Thomas W. and Ndi, George, "Stabilizing International Investment Commitments: International Law Versus Contract Interpretation", Texas International Law Journal, Vol. 31, (1996).
26. Wehberg, Hans, "Pacta Sunt Servanda", American Journal of International Law, Vol. 53, (1959).

Laws

1. Agricultural and Industrial Expansion Proclamation, Proclamation No. 145/1954, Negarit Gazetta, 14th year, No.3.
2. Government Ownership and Control of Means of Production Proclamation, Proclamation No. 26/1975, Negarit Gazetta, 34th year, No. 22.
3. Investment Decree, Decree No. 51/1963, Negarit Gazetta, 23rd Year, No.1.
4. Notice for Encouragement of Foreign Capital Investment, Notice No. 10/1950, Negarit Gazetta, 9th Year, No.6.
5. Petroleum Operations Proclamation No. 295/1986, Negarit Gazetta, 45th Year, No. 6.
6. The Council of State Decree No. 39/1990, the Decree to Ratify the MIGA Convention, Negarit Gazetta, 50th year, No.1

Treaties

1. Agreement between FDRE Government and the Government of the Republic of the Sudan for Reciprocal Promotion and Protection of Investments (2000).
2. Agreement between FDRE Government and the Government of the Republic of Tunisia for Reciprocal promotion and protection of Investments (2000).

3. Agreement between the Government of Swiss Confederation and FDRE Government on Promotion and Reciprocal protection of Investments (1998).
4. Agreement between FDRE Government and the Government of the Republic of Yemen for Reciprocal protection and promotion of Investments (1999).

Concession Agreements

1. Contract of Concession between the Imperial Ethiopian Government and Ethiopian Potash Company (1968).
2. Model Production Sharing Agreement for the Exploration and Production of Petroleum with the Government of Ethiopia (1994).
3. Petroleum Development Agreement by and between the Empire of Ethiopia and Gulf of Oil Company of Ethiopia (1963).
4. Production Sharing Agreement for the Exploration and Production of Petroleum between the Government of Peoples Democratic Republic of Ethiopia and B. P. Petroleum Development Ltd.
5. Production Sharing Agreement in an Area of North Eastern Ethiopia between the Government of Ethiopia and Afar Exploration – Company, LLC of Tulsa, U.S.A. (2005).
6. Production Sharing Petroleum Agreement between the Government of Peoples Democratic Republic of Ethiopia and Ethiopia Hunt Oil Company (1990).
7. The Addis Ababa – Modjo – Awassa Road Rehabilitation Project Works Contract between Ethiopian Government and Dragados- Zeus Joint Venture (1997).
8. The Agreement between Ethiopian Roads Authority and China National Water Resources and Hydropower Engineering Corporation (2002).

9. The Concession Agreement between the Imperial Ethiopian Government and the British – Canadian Mining Corporation (1969).

Other Bibliographic Materials

1. Getahun Damte, Investment Decree No. 51/1963 (Unpublished Senior Thesis, H.S. I. U, Faculty of Law, 1966).
2. MIGA, Investment Guarantee Guide, the Multilateral Investment Guarantee Agency: A Member of the World Bank Group (1996).
3. World Bank, Annual Report (1993)
4. World Bank, Annual Report (1997).

The thesis, my original work, has not been presented for a degree in any other university and that all sources of material used for the thesis have been duly acknowledged.